No. 721 [redacted] 1

In the Supreme Court of the United States

OCTOBER TERM, 1942

THE NORTH AMERICAN COMPANY, PETITIONER

v.

SECURITIES AND EXCHANGE COMMISSION

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION

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OPINIONS BELOW

The opinion of the Circuit Court of Appeals for the Second Circuit is reported in 133 F. (2d) 148. The Findings and Opinions of the Commission (1 R. 73–192) are published in Holding Company Act Release Nos. 3405 and 3629 but are not yet officially reported.

JURISDICTION

The decree of the Circuit Court of Appeals for the Second Circuit was entered on January 28, 1943. The petition for a writ of certiorari was granted March 1, 1943. The jurisdiction of this

Court is invoked under Section 240 (a) of the Judicial Code as amended by the Act of February 13, 1925, made applicable by Section 24 (a) of the Public Utility Holding Company Act of 1935.

QUESTIONS PRESENTED

1. Is Section 11 (b) of the Public Utility Holding Company Act within the power of Congress to regulate commerce among the several states?

2. Does Section 11 (b) of the Act as applied by the Commission to the petitioner violate the due process clause of the Fifth Amendment?

STATUTE INVOLVED

The statute involved is the Public Utility Holding Company Act of 1935 (Act of August 26, 1935, c. 687, 49 Stat. 803). The relevant provisions of Sections 1, 2, 3, 4, and 11 of the statute are set forth in Appendix A, *infra,* pp. 103–115.

Broadly speaking, the Act provides for the regulation of electric and gas utility holding company systems. Its major provisions are of three types:

1. A requirement of registration of public utility holding companies which are engaged in interstate commerce or use the mails;

2. Substantive regulations of registered holding companies with respect to such matters as the issuance of securities, the sale and acquisition of assets, the payment of dividends, etc.; and

3. Corporate simplification and integration provisions as contained in Section 11 of the Act.

It is the latter provisions which are before the Court in the present case.

STATEMENT

A. BACKGROUND OF THE STATUTE

Control of the electric and gas utility industry as it affects our national economy has been the subject of Congressional concern for many years.

In December, 1924, there was introduced in the United States Senate (68th Congress) Senate Resolution 286 charging General Electric Company with exercising undue control over the electric power industry, and shortly thereafter the Senate adopted Senate Resolution 329 (68th Congress, 2d Session) directing the Federal Trade Commission to investigate to what extent and by what means the General Electric Company or its security holders "* * * monopolize or control the production, generation or transmission of electric energy or power."[1]

In 1928 the Senate directed the Federal Trade Commission to conduct an investigation of electric and gas utility and holding companies (S. Res. 83, 70th Cong., 1st sess.). The resulting periodic reports made to the Senate by the Federal Trade

[1] Shortly thereafter General Electric distributed to its stockholders its interest in securities of the Electric Bond and Share Company, the utility holding company which was before this Court in *Electric Bond & Share Co.* v. *Securities and Exchange Commission*, 303 U. S. 419.

Commission cover 101 volumes representing an exhaustive investigation of the utility industry.[2]

The House of Representatives also conducted an investigation in this field. Pursuant to H. Res. 59, 72d Cong., 1st sess., and H. J. Res. 572, 72d Cong., 2d sess., a report on the Relation of Holding Companies to Operating Companies in Power and Gas Affecting Control (popularly known as the Splawn Report) was made by the House Committee on Interstate and Foreign Commerce. This report consists of six parts, reported during the years 1933 to 1935.

In order to coordinate national policy on utility problems, the President of the United States in 1934 appointed the National Power Policy Committee, with membership consisting of representatives of governmental departments concerned with power problems. The report of this committee on Public Utility Holding Companies was submitted by the President to Congress on March 12, 1935 (House Document No. 137, 74th Cong., 1st sess.).

The reports of the Federal Trade Commission, the Splawn Report, and the Report of the National Power Policy Committee all concluded that the utility holding company was a highly deleteri-

[2] This has been called "the most thoroughgoing investigation of an American industry that has ever appeared." Barnes, *The Economics of Public Utility Regulation* (1942), p. 71. The reports, to which frequent references will be made, are cited "*Utility Corporations*, Part—."

ous device, peculiarly susceptible of abuses, and having a harmful effect on the economy of the nation.[3] They traced the development of the holding company from its beginnings, when Electric Bond and Share Company and United Gas Improvement Company were organized by manufacturers of utility equipment to find a market for their product,[4] to 1935, by which time holding companies had grown into enormous, often multi-billion dollar enterprises, 15 of them controlling the generation of 80% of the electricity generated by private utility companies in the United States.[5] Similarly, in the gas utility industry, by 1932, 11 holding company systems controlled 80% of the total mileage of natural gas pipelines upon which the gas fields are almost completely dependent for the marketing of their product.[6]

The figures of the Federal Power Commission show that 19.8% of the electric power production for December 1941, or 3 billion kilowatt-hours, was in interstate movement. Federal Power Commission, "Production and Utilization of Electric Energy in the United States," January 23, 1942. The Federal Trade Commission found that

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[3] *Utility Corporations*, Part 72–A, p. 64; Splawn Report, Part 2, p. VIII; Report of National Power Policy Committee, House Document No. 137, 74th Cong., 1st sess., pp. 4–8.

[4] *Utility Corporations*, Part 72–A, pp. 86–102.

[5] Id. at pp. 37–44.

[6] Report of National Power Policy Committee to the President, *supra*, n. 3.

holding companies controlled 98.5% of the electric energy transmitted in interstate commerce. *Utility Corporations*, Part 72–A, p. 43, Table 13. In the interstate movement of natural gas the holding companies are also dominant. In 1930 the Federal Trade Commission found that holding companies were responsible for 79.5% of the interstate flow. *Id.* at p. 50, Table 16.

A dominant characteristic of holding companies was found to be the concentration of management of the nation's utilities in a few financial centers. We are attaching as Exhibit B to this brief a chart showing the approximate dollar amount of consolidated assets of the 20 largest holding company systems, the location of their general headquarters, the number of utility subsidiaries of each, the number of states where those subsidiaries operate, and both the maximum and the average distance of the system headquarters to the subsidiaries. These 20 largest systems have combined assets of approximately $15,300,000,000 out of a total of some $16,000,000,000 of assets in the 53 holding company systems registered with the Commission under the Act.[7] In the light of information of this nature, the reports pointed out that the typical holding company system was a huge interstate enterprise

[7] "Registered Public Utility Holding Companies, August 15, 1942," Report of Public Utilities Division, Securities and Exchange Commission.

generally controlled from financial centers remote from the utility properties.

These were the systems which the Federal Trade Commission, the Splawn Report, and the National Power Policy Committee all agreed must no longer be permitted to dominate a large segment of our national economy, to the detriment of a nationwide group of investors and both industrial and residential consumers.

The President's message to the Congress, transmitting the report of the National Power Policy Committee, said:

> We do not seek to prevent the legitimate diversification of investment in operating utility companies by legitimate investment companies. But the holding company in the past has confused the function of control and management with that of investment and in consequence has more frequently than not failed in both functions. Possibly some holding companies may be able to divest themselves of the control of their present subsidiaries and become investment trusts. But an investment company ceases to be an investment company when it embarks into business and management. Investment judgment requires the judicial appraisal of other people's management.
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> * * * * *
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> But where the utility holding company does not perform a demonstrably useful and necessary function in the operating

industry and is used simply as a means of financial control, it is idle to talk of the continuation of holding companies on the assumption that regulation can protect the public against them. Regulation has small chance of ultimate success against the kind of concentrated wealth and economic power which holding companies have shown the ability to acquire in the utility field. No Government effort can be expected to carry out effective, continuous, and intricate regulation of the kind of private empires within the Nation which the holding-company device has proved capable of creating.

Except where it is absolutely necessary to the continued functioning of a geographically integrated operating utility system, the utility holding company with its present powers must go. If we could remake our financial history in the light of experience, certainly we would have none of this holding-company business. It is a device which does not belong to our American traditions of law and business. It is only a comparatively late innovation. It dates definitely from the same unfortunate period which marked the beginnings of a host of other laxities in our corporate law which have brought us to our present disgraceful condition of competitive charter-mongering between our States. And it offers too well-demonstrated temptation to and facility for abuse to be tolerated as a recognized business institution. That temptation and that

facility, are inherent in its very nature. It is a corporate invention which can give a few corporate insiders unwarranted and intolerable powers over other people's money. In its destruction of local control and its substitution of absentee management, it has built up in the public-utility field what has justly been called a system of private socialism which is inimical to the welfare of a free people.

Most of us agree that we should take the control and the benefits of the essentially local operating utility industry out of a few financial centers and give back that control and those benefits to the localities which produce the business and create the wealth. We can properly favor economically independent business, which stands on its own feet and diffuses power and responsibility among the many, and frowns upon those holding companies which, through interlocking directorates and other devices, have given tyrannical power and exclusive opportunity to a favored few. It is time to make an effort to reverse that process of the concentration of power which has made most American citizens, once traditionally independent owners of their own businesses, helplessly dependent for their daily bread upon the favor of a very few, who, by devices such as holding companies, have taken for themselves unwarranted economic power. I am against private socialism of concentrated private power as thoroughly as I am against governmental socialism.

> The one is equally as dangerous as the other; and destruction of private socialism is utterly essential to avoid governmental socialism. (S. Rep. 621, 74th Cong., 1st sess., pp. 2 and 3.)

Upon receipt of this message, bills to carry out its recommendations were introduced in both the House and Senate. These bills provided for the elimination of holding companies in five years if they could not demonstrate their usefulness to the operating companies. After extensive hearings in both the House and Senate divergent bills were reported out. The Senate bill required complete elimination of holding companies except in situations where the Federal Power Commission should issue a certificate finding that the continuance of a holding company was necessary (S. 2796, 74th Cong., June 13, 1935); while the House bill directed the Securities and Exchange Commission to limit each holding company system to a single integrated public utility system "except that if the Commission finds that it is not necessary in the public interest to so limit the operations of such holding company system, the order of the Commission shall require such company to take only such action * * * as the Commission finds necessary to limit such operations to such number of integrated public utility systems as it finds may be included in such holding company system consistently with the public interest." (S. 2796; House

Rep. No. 1318, 74th Cong., 1st sess., June 24, 1935.)

The bills were passed in each house in approximately the forms in which they were introduced. Conferees of the House and Senate worked out a compromise bill which was enacted as the Public Utility Holding Company Act of 1935, which in Section 11 (b) (1) limits each holding company to a single integrated system, related other businesses, and additional systems in certain narrow circumstances; and in Section 11 (b) (2) requires the simplication of such systems.

B. THE PRESENT PROCEEDINGS

The proceedings before the Commission were instituted by a Notice of and Order for Hearing under Section 11 (b) (1) of the Act, dated March 8, 1940 (R. 1). Hearings were commenced on June 21, 1940, before an examiner appointed by the Commission and were closed on April 15, 1941. On April 14, 1942, the Commission issued its Findings and Opinion (1 R. 73–192) and its Order (1 R. 194–204).

1. THE NORTH AMERICAN SYSTEM

North American controls companies whose assets are carried on their books at more than $2,300,000,000 (1 R. 84–86). Briefly, the North American system consists of eighty companies, operating chiefly electric and gas utility properties in seventeen states and the District of Columbia,

from Washington, D. C., to California, and from northern Michigan to southern Kansas and Missouri. Electric service alone is rendered to more than 3,000,000 customers spread over an area of some 165,000 square miles with a population in excess of 12,000,000. The principal territories served are St. Louis, the District of Columbia, Milwaukee, Cleveland, Detroit,[8] and extensive portions of Illinois, Iowa, Kansas, Missouri, and California. (*Ibid.*) A map showing the location of the electric service territories of the system is attached to this brief as Appendix C, *infra*; p. 118.

Gas Service is rendered by North American system companies in the states of Iowa, Missouri, Nebraska, Minnesota, Illinois, Kansas, Wisconsin, Michigan, and California. Appendix D, *infra* p. 119, is a map showing the location of gas operations of the system.

Appendix E, *infra* p. 120, is a map showing the air-line distances of various focal points in the territories served from the central offices of North American in New York City.

North American's relationship to these vast enterprises has not been solely that "of a large investor seeking to promote the sound development of his investment" (Pet. Br. 8). North

[8] Petitioner, since the institution of these proceedings, disposed of substantially its entire holdings of Detroit Edison by declaring common stock dividends payable in such stock, cash income being used to retire a portion of petitioner's indebtedness. *North American Company*, Holding Company Act Release No. 4056 (1943).

American has *control* over these scattered enterprises. As to only two of its subsidiaries, the Detroit Edison Company and Pacific Gas & Electric Company, was a claim raised that they were not controlled by or subject to a controlling influence of petitioner. After hearings in exemption proceedings the Commission rejected both claims and on appeal its determinations were sustained.[9]

The system companies are also engaged in the following businesses, in some cases a company being engaged in more than one business: holding company, natural gas production, natural gas transmission, steam and hot water heating, water supply, railroad, urban and interurban transportation, terminal and warehousing, real estate, coal mining, ice manufacturing and distribution, trucking, parking lot and filling station operation, meter servicing, heavy appliance design and manufacture, amusement park operation, investment company, oil drilling and gasoline extracting (1 R. 84).

The offices of North American are located at 60 Broadway, New York City. It has more than 58,000 common stockholders residing in every state of the Union (Pet. Br. p. 66). Of its board of directors of 12 persons nine are officers of North

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[9] See *Detroit Edison Co.* v. *Securities & Exchange Commission*, 119 F. (2d) 730 (C. C. A. 6), certiorari denied, 314 U. S. 618; *Pacific Gas & Electric Company* v. *Securities & Exchange Commission*, 127 F. (2d) 378 (C. C. A. 9), petition for rehearing granted June 6, 1942.

American or of one or more of its subsidiaries (9 R. 3314–3323).

2. THE COMMISSION'S ORDER

In the administrative proceedings petitioner urged that it should be permitted to retain its holdings in and around St. Louis, Cleveland, and Milwaukee (each of which the Commission found to be an integrated system, the first and third being interstate systems). In the face of repeated refusals by petitioner to select a "single" system, the Commission designated the St. Louis properties as such and found that the Cleveland and Milwaukee properties did not meet the standards in the proviso to Section 11 (b) (1) for retention with the St. Louis properties as "additional" systems.[10]

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[10] Petitioner states (Pet. Br. 4) that "the order of June 25, 1942, refused permission to the petitioner to choose for itself the integrated public utility system which it might retain." The Act places the responsibility for the limitation of holding company systems solely in the Commission, but the Commisison sought the benefit of petitioner's judgment in that regard. The fact is that petitioner was given repeated opportunities to indicate a choice as to its retainable integrated system, but it persistently refused to do so, taking the position that the Commission could not and it would not so select. Even the principal order here under review, dated April 14, 1942, provided "that notwithstanding the provisions of * * * the Commission's Rules of Practice, The North American Company * * * may, within 15 days of the date hereof, petition for leave to present further argument and proffer additional evidence as follows: (1) The North American Company may petition for opportunity to present

In regard to certain non-utility businesses of petitioner such as its interests in a coal mine, an investment company and a holding company owning real estate and stock in a heavy equipment manufacturing company, the Commission held that the properties were not retainable by petitioner. The basis of this finding was the Commission's interpretation of the provisions in the Act relating to the retention of "other businesses." The Commission construed those clauses to permit retention only when it appears "that the public interest will be furthered by retention of a non-utility interest by reason of its relation 'to economy of management and operation' of a public utility system or systems or 'the integration and coordination of related operating properties'" (1 R. 117). Since the properties in question were not

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further argument or additional evidence on the question whether any single integrated public utility system, other than the integrated electric utility system of the Union group as described in our Findings and Opinion herein this day issued, shall serve as its principal system * * *" (1 R. 201). Petitioner did not avail itself of this opportunity, but again challenged the Commission's right to select a system. The Commission's Order of June 25, 1942, rejected this challenge (R. Vol. I, p. 214). At no point did petitioner claim that the Union system was not an appropriate selection on the merits; on the contrary, there were numerous indications that if petitioner had to make a choice the Union system would be elected and the Commission relied, in part, on those indications in making its decision to restrict petitioner to Union (1 R. 90-91).

related to the operations of the integrated Union Electric system, the Commission ordered their divestment.

The Commission further rejected petitioner's argument that orders might not be entered under Section 11 (b) (1) until the Commission had completed general industry-wide studies under Section 30 of the Act.

Thus the Commission ordered a limitation of the operations of petitioner's system to its integrated interstate public utility system in and around St. Louis, Missouri. Jurisdiction was retained to consider whether a gas system in the suburbs of St. Louis and petitioner's office building in New York City might be retained, but petitioner was ordered to "sever its relationship" with all of its other properties "by disposing or causing the disposition, in any appropriate manner not in contravention of the applicable provisions of the said Act or the Rules and Regulations promulgated thereunder, of its direct and indirect ownership, control and holding of securities issued and properties owned, controlled or operated" by the subsidiary companies involved (1 R. 195).

3. THE OPINION BELOW

On petition for review filed in the United States Circuit Court of Appeals for the Second Circuit, the Commission's order was sustained in every particular; the court further rejected petitioner's arguments, which it brings to this

Court, that Section 11 (b) (1) of the Act is beyond the power of Congress to regulate commerce among the several states, and violates the Fifth Amendment.

SUMMARY OF ARGUMENT

Section 11 (b) applies only to companies within the scope of the commerce power. Registered holding companies are those which use the channels of interstate commerce in their business; and predominantly intrastate companies within the effective control of a single state are not required to comply with the provisions of the Act.

The North American system is clearly an interstate enterprise. Petitioner controls some 80 companies, including ten direct subsidiaries, operating chiefly electric and gas utility properties in seventeen states and the District of Columbia, from the Atlantic to the Pacific seaboards, and from Michigan to Kansas and Missouri. Petitioner concedes that some of its important subsidiaries are engaged in interstate transmission of energy. Moreover, extensive sales of securities of companies in the system by public offerings in interstate commerce have taken place; in addition, North American exercises its control over subsidiaries through the instrumentalities of interstate commerce. These activities are the essence of the business of the system.

Congress has found in Section 1 (a) of the Act that the activities of registered holding companies affect interstate commerce, and in Section

1 (b) has detailed persistent and widespread abuses characteristic of utility holding companies. These abuses relate to security issues; to dealings not at arm's length; to control of operating companies through disproportionately small investment; to lack of integration and coordination of operating properties and lack of economies; and to impairment of state regulation. The findings of Congress are amply supported by the official reports of investigating bodies to which the Act refers. These abuses are spread and perpetuated by the business activities of utility holding companies carried on in interstate commerce, to the detriment of consumers and investors. The volume of interstate transmission, the dependence of interstate commerce on electricity and gas, the interstate marketing of securities and performance of financial and other services, all warrant Congressional action to eliminate or ameliorate the abuses of which utility holding companies are peculiarly susceptible.

The Act is in the conservative tradition of federalism. It preserves state regulation of local utility operations, and Section 11 (b) in particular was designed to restore and strengthen the power of the states to deal effectively with local operating utilities. Congress might have exercised its power by prohibiting the use of the channels of interstate commerce for the spread of harm caused by characteristic holding company practices. But Congress was not limited to that sanc-

tion. It was at liberty to reach the evil at its source, as it has done in other statutes, notably the antitrust laws. Divestment and dissolution are familiar remedies in this field.

The Act does not violate the Fifth Amendment. There is no taking of property. There is no inviolable right in investors to retain holding company securities rather than securities in the underlying companies. Moreover, any claim of loss is speculative, and responsible sources estimate an increase in market value of investors' interests through corporate simplification and integration. The Act may be applied to corporate structures antedating the statute, as the antitrust cases show.

ARGUMENT

I. SECTION 11 (b) OF THE ACT IS WITHIN THE COMMERCE POWER

A. REGISTERED HOLDING COMPANY SYSTEMS SUCH AS PETITIONER ARE INTERSTATE ENTERPRISES WHOSE SIGNIFICANT ACTIVITIES ARE CARRIED ON IN INTERSTATE COMMERCE AND SUBSTANTIALLY AFFECT SUCH COMMERCE

1. *The statutory scheme*

The provisions of the Act are so designed that Section 11 (b) will be applied only to companies properly within the scope of Congressional power under the commerce clause. Section 11 (b) applies its integration and simplification provisions only to "registered" holding companies. By definition (Sec. 2 (a) (7) of the Act), a holding company is a company which controls an electric or

gas utility company. The definition creates a presumption that a holding of 10% of voting securities constitutes control, but this presumption may be rebutted by showing lack of control or controlling influence. The essential test under the Act of the holding-company-subsidiary relationship is the test of control.[11] Consequently, no company need comply with Section 11 of the Act if it is merely an investor in other companies and does not control such other companies. The Act requires (Section 4 (a)) registration of any utility holding company which uses the instrumentalities of interstate commerce directly or through its subsidiaries in the operation of its business.[12]

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[11] Petitioner frequently appears to argue that under the Act such ten percent ownership is conclusive of a holding company-subsidiary company relationship, so that that relationship involves merely the ownership of securities, but the provisions of Sections 2 (a) (7) and 2 (a) (8) clearly show the inaccuracy of petitioners' approach. And see p. 13, n. 9, *supra*.

[12] The Act also requires registration of holding companies which use the mails in the operation of their businesses. However, we are confining this discussion to interstate commerce since we believe that if the relation of holding companies to interstate commerce will sustain the validity of requiring registration under the commerce clause, a similar relation to the use of the mails will sustain similar regulation under the postal power. We do not understand that petitioner questions this conclusion, and in any event discussion of the postal power would be academic, in view of petitioner's obligation to register because of its interstate activities.

Registration of a utility holding company is also required under Section 4 (b) if it has distributed any of its securities

But not all companies which are involved in interstate activities are required to comply with the provisions of Section 11 (b), the integration and corporate simplification section of the Act. Holding companies, even though they use the instrumentalities of interstate commerce in the operation of their business, may obtain exemption from the provisions of the Act if predominantly intrastate in their operations and within the effective control of a single state. Section 3 (a) (1) and (2) of the Act provides as follows:

> Sec. 3. (a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company, and every subsidiary company thereof as such, from any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—
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> (1) such holding company, and every subsidiary company thereof which is a

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by means of an interstate public offering since January 1, 1925, provided any such securities are owned by persons not resident in the same state as the holding company at the time of the enactment of the statute. Relations between the holding company and its out-of-state security holders, such as transmittal of interest, dividends, proxies, notices of meetings, etc., are continuing relationships which of necessity are maintained by the use of the mails and facilities of interstate commerce; but in any event the petitioner was required to register because of the requirements of Section 4 (a) of the Act, and it thus appears that the requirement of Section 4 (b) is not here involved.

public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized;

(2) such holding company is predominantly a public-utility company whose operations as such do not extend beyond the State in which it is organized and States contiguous thereto;

Thus, in spite of petitioner's argument that Section 4 may cause the registration of holding companies whose engagement in commerce is only sporadic or incidental, it is clear that the Act contains ample safeguard that local holding companies will not be regulated.

Petitioner disputes this argument because of the requirement for exemption in Section 3 (a) (1) that the holding company and all of its important utility subsidiaries be incorporated in the state where those utilities operate. Petitioner contends that this requirement is unrelated to interstate commerce. We think it is clear that the state of incorporation bears an important relation to the effectiveness of state regulation of utilities[13] sell-

[13] It has long been recognized as a peculiarly appropriate field for governmental regulation, to determine the conditions under which a number of individuals may combine their resources and activities through incorporation. Par-

ing electricity and gas in interstate commerce and to consumers engaged in such commerce, and that hence the exemption is appropriately qualified; but in any event, that is not this case, for, as petitioner admits, it would not have a Section 3 exemption available to it under any circumstances, its utility operations being scattered in seventeen states and the District of Columbia.

Petitioner also complains that exemptions under Section 3 (a) (1) need not always be granted to those eligible to apply for them since the Act extends such exemption "unless and except insofar as it [the Commission] finds the exemption detrimental to the public interest or the interest of investors or consumers." Petitioner argues that this qualification, similar to that of the domiciliary requirement discussed above, is unrelated to interstate commerce and that therefore Section 3 (a) does not provide for exemption for predominantly intrastate holding companies. We repeat that in no event could petitioner be eligible for a Section 3 (a) (1) exemption, because of the thoroughly interstate character of its system and operations, and consequently its argument based on the "unless and except" clause is an attempt to argue exemption cases which may never

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ticularly is this so where the business is one affected with a public interest. This local control is circumvented where it is the holding company, incorporated in another state, which is the significant corporate entity through which the controlling group of investors pool their interests.

arise. In fact, however, the policy which the Commission is required to apply in considering exceptions to Section 3 (a) exemptions is the policy set forth in Section 1 (c) of the Act, as follows:

> * * * it is hereby declared to be the policy of this title, *in accordance with which policy all the provisions of this title shall be interpreted,* to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are *engaged in interstate commerce or in activities which directly affect or burden interstate commerce;* * * * [Italics supplied.]

The Commission has never yet had occasion to deny exemption under the "unless and except" clause of Section 3 (a) to a holding company found to be "predominantly intrastate" in character within clause (1). It should be noted that Section 3 (a) refers to exemption from any provision or provisions of the Act. It is conceivable that a holding company system while predominantly intrastate in character nevertheless is engaged in activities which burden or affect interstate commerce, and this may be found to warrant denial of exemption from some, if not all, of the provisions of the Act.

2. *The application of the statute to the North American system*

The interstate character of petitioner is clear from an examination of its operations.

Petitioner is incorporated in New Jersey. There is a total of some 80 companies in its system. It has 10 direct subsidiaries, of which 3 are registered holding companies: Union Electric Company of Missouri operating in and around St. Louis, Missouri, and with subsidiaries operating in Illinois and Iowa as well; Washington Railway and Electric Company whose subsidiaries operate in the District of Columbia and adjacent territory in Virginia and Maryland; and North American Light & Power Company which operates extensive systems in Kansas, Missouri, Illinois and Iowa. Some of the subsidiaries of North American Light & Power Company are also registered holding companies (1 R. 84–86).

Four of the direct subsidiaries of North American are operating companies: Cleveland Electric Illuminating Company; Pacific Gas & Electric Company; The Detroit Edison Company; and Wisconsin Electric Power Company (a holding company which with its subsidiaries operates an integrated system in Wisconsin and Michigan, known as Wisconsin-Michigan; this Company has on file with the Commission an application for exemption under Section 3 (a) (2) of the Act as predominantly an operating rather than a holding company).

The remaining three direct subsidiaries of North American are North American Utility Securities Corporation, an investment trust; West Kentucky Coal Company which owns and operates

a coal mine in Kentucky and sells the coal in several states; and 60 Broadway Building Corporation which owns the office building in New York City where Petitioner has its offices.

North American controls all of these companies from its central offices in New York. The operations of petitioner's system are conducted in 17 states and the District of Columbia (1 R. 84–86). It is important to note that none of the utility operations of the North American system—by far the preponderant business of the system—is conducted either in New Jersey where petitioner is incorporated or in New York where is located its principal place of business, and only two of the non-utility businesses of petitioner are conducted in New York: the office building and North American's investment trust.

Petitioner has conceded that Wisconsin Electric Power Company, Union Electric Company of Missouri, Washington Railway and Electric Company, and North American Light & Power Company are engaged in interstate commerce.[14]

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[14] Union Electric Company of Illinois, for example, in the year 1940, sold 1,200,000,000 kilowatt-hours of electric energy to its parent, Union Electric Company of Missouri, all of which crossed the Illinois-Missouri border. (*Ibid.* R. North American Exhibit No. 146.) While not strictly comparable because of the difference in period, the magnitude of this figure is indicated by the fact that in 1939 the total output of the entire Union Electric system was 2,468,000 kilowatt-hours (9 R. 3268). Other interstate transmission of electricity in substantial amounts takes place in the North American system between the District of Columbia and

It claims that Cleveland, Pacific Gas and Detroit Edison are not engaged in interstate commerce. It argues that since a particular subsidiary may not be engaged in interstate commerce and North American's relation with it is merely that of a holder of securities, asserted to be a purely intrastate activity, Congress has no power to require divestment.

This argument overlooks a vital characteristic of the relationship between petitioner and its subsidiaries. Petitioner not only holds more than 10 percent of the voting securities of its subsidiaries but also controls them. Petitioner's reiteration of its contention that it is a mere "investor" in its various utility enterprises must be contrasted with the plain fact—not explicitly contested—that it controls its subsidiaries and that their acts are its acts. *Electric Bond & Share Co.* v. *Securities and Exchange Commission,* 303 U. S. 419, 440.

North American has, either directly or through its subsidiaries engaged in all the types of activities mentioned in the *Bond & Share* case as a basis for federal regulation.[14a] Here is presented the situation of a New Jersey corporation with its principal place of business in New York controlling utility

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both Maryland and Virginia, between Iowa and Missouri, and between Wisconsin and Michigan.

[14a] It is true that petitioner does not have a service company which renders and charges for services to its subsidiaries. However, services including financial advice are rendered by North American itself without charge (1 R. 101). The difference is one of degree, not kind.

companies incorporated and doing business in a great many states. Furthermore, the control is effectuated by use of the mails and facilities of interstate commerce, as when proxies are sent, e. g., from New York to Ohio, instructions or "advice" given, reports received, and the like. This relationship is obviously an interstate relationship. For example, the system sold almost half a billion dollars in securities in the three years between registration and September 1940 (9 R. 3308, 3309), and it will not be disputed, as the registration records of the Commission show, that these were largely interstate flotations.[15] The transactions involve the essence of petitioner's business and are commercial transactions which constitute commerce within the meaning of the commerce clause,[16] and since these transactions in commerce are carried out and performed by the use of the facilities of interstate commerce and "concern more states than one" they constitute interstate commerce within the meaning of the commerce clause.[17] See *The Minnesota Rate*

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[15] The North American Company itself has securities holders in every state of the Union (Pet. Br. 66) and has its debentures and preferred and common stocks listed on the New York Stock Exchange where they are actively traded. Most of the securities issued by the various companies in the North American system and not owned by system companies are similarly traded on national securities exchanges.

[16] *Associated Press* v. *National Labor Relations Board*, 301 U. S. 103, 128, and cases cited.

[17] The fact that many of these instances of communication and transportation do not occur between a vendor and vendee

Cases, 230 U. S. 352, 398; *Second Employers' Liability Cases,* 223 U. S. 1, 46; *Gibbons* v. *Ogden,* 9 Wheat. 1, 194, 195; *International Textbook Co.* v. *Pigg,* 217 U. S. 91, 107.

Plainly Congress was not acting outside its proper sphere when it dealt with the North American Company. And the North American Company is "typical" of the holding companies subject to Section 11 (b). See Brief, *Amici Curiae,* p. 6.

3. *Congress has determined that the activities of registered holding companies affect interstate commerce*

It is true, as petitioners state, that the Act contains no provision for specific finding by the Commission or by a court that the particular company subjected to an order under Section 11 (b) shall itself be engaged in interstate commerce or that the situations corrected by the order shall in the particular case have an effect on interstate commerce. But such a provision was unnecessary since Congress itself has required compliance by all properly registered holding companies and in so doing it evidenced its conclusion that they so affect interstate commerce that it is proper to apply the provisions of Section 1 (b) to them. In *United States* v. *Darby,* 312 U. S. 100, 120–121, this Court stated:

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is not material for purposes of Congressional power under the commerce clause. *The Pipe Line Cases,* 234 U. S. 548, 560; *United States* v. *Hill,* 248 U. S. 420, 423, 424.

> In such legislation Congress has sometimes left it to the courts to determine whether the intrastate activities have the prohibited effect on the commerce, as in the Sherman Act. It has sometimes left it to an administrative board or agency to determine whether the activities sought to be regulated or prohibited have such effect, as in the case of the Interstate Commerce Act, and the National Labor Relations Act, or whether they come within the statutory definition of the prohibited Act, as in the Federal Trade Commission Act. And sometimes Congress itself has said that a particular activity affects the commerce, as it did in the present Act [the Fair Labor Standards Act of 1938], the Safety Appliance Act and the Railway Labor Act. In passing on the validity of legislation of the class last mentioned the only function of courts is to determine whether the particular activity regulated or prohibited is within the reach of the federal power. See *United States* v. *Ferger, supra; Virginian Ry. Co.* v. *Federation,* 300 U. S. 515, 553.

The statute before the Court here clearly comes within the third category, in which the determination of the relation to interstate commerce is made by the Congress itself. That determination is inherent in the enactment of the statute itself. By adopting sections 2, 3, 4, and 11 of the Act Congress was asserting and declaring that the actions required of companies properly subject

to Section 11 under this statutory scheme were so related to the exercise of the commerce power as to require no additional finding by the Court or the Congress. This Court cited *United States* v. *Ferger*, 250 U. S. 199, and *Virginian Railway Co.* v. *Federation*, 300 U. S. 515, in the *Darby* case, *supra*, as cases of determination by the Congress which obviated the necessity of findings by an administrative agency or a court. See also *Colorado* v. *United States*, 271 U. S. 153. The statutes sustained by these cases contain no statement by Congress that the activity regulated was related to interstate commerce. The finding must therefore have been implied from the mere enactment of the statute and from the character of the regulation applied. Disregarding Section 1, the same is true here.

But in any event Congress in the present Act did provide an extensive explanation of its determination, in the declarations of policy contained in Section 1 of the Act. Congress in this declaration finds a widespread and frequent involvement of the activities of public utility holding companies in interstate transactions and from this draws the conclusion that such companies are "affected with a national public interest."[18]

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[18] Petitioner ignores those declarations in Section 1 (a) which refer to activities of subsidiary companies and practices of holding companies in respect thereof, on the ground that ownership of securities is not a practice in respect of subsidiary companies. But section 1 (a) (4) speaks explicitly of "control over subsidiary companies," and it is precisely such control which makes North American a hold-

Congress finds that when the abuses detailed in Section 1 "become persistent and widespread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public" (Section 1 (c)). It then declares (Section 1 (c)) that it is the policy of the Act, "in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce." Having declared this policy Congress adopted, among others, Section 11 as well as the other regulatory provisions of the Act.[19] It would seem difficult to find a clearer statement that Congress regarded public utility holding companies as so much involved in interstate commerce and a source of so frequent abuses that the provisions of Section 11 were an appropriate exercise of the commerce power.

Petitioner, however, brings a highly technical approach to these declarations of legislative

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ing company and which will be eliminated by the disposition of the ownership of the securities now held by North American and ordered divested by the Commission.

[19] Petitioner and *Amici curiae* point out that they are challenging only Section 11, and not the other regulatory provisions. Yet their argument as to lack of findings would strike at every provision of the Act, including the registration provisions upheld in the *Electric Bond & Share* case.

policy. It is pointed out that Congress stated in Section 1 (a) of the Act five reasons why public utility holding companies are affected with a national public interest and are matters of concern under the commerce clause, and that with regard to three of those reasons Congress stated that the effects on interstate commerce occur "often". The declaration of affectation with a national public interest, and the cataloging of reasons, some of which occur universally (Secs. 1 (a) (1) and 1 (a) (5)), and some of which occur frequently (Sec. 1 (a) (2), (3) and (4)), is not only careful draftsmanship but is clearly a sufficient basis for Congressional power. The effect of abuses on interstate commerce need not be invariable; it is enough that the effect "from time to time does" occur and that the abuse is likely to recur as a "constantly possible danger." *Chicago Board of Trade* v. *Olsen,* 262 U. S. 1, 40.

Petitioner states that the declaration concerning the abuses and evils in Section 1 (b) "clearly implies that such conditions are not general." This statement is in direct contradiction both to the Congressional declaration that when such abuses become "persistent and widespread" regulation is necessary and the actual adoption of regulations by the Congress. The use of the word "when" as a means of stating a factual premise is at least as old as the Declaration of Independence.

4. Registered holding company systems are characteristically engaged in interstate activities.

There is no better summary of the ways in which holding companies affect interstate commerce than the statement in Section 1 (a) of the Act:[20]

> (a) Public-utility holding companies and their subsidiary companies are affected with a national public interest in that,

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[20] The legislative materials amply support the Congressional findings. See, e. g., as to the five findings in Section 1 (a):

(1) *Utility Corporations*, Part 72–A, pp. 346–348, 536–542. As to petitioner, the Federal Trade Commission found:

"One of the functions of The North American Co. was the negotiation for issues of senior securities of its subsidiaries. In the record a tabulation of such securities for the period 1920 to 1930 indicates that The North American Co. negotiated for the sale of over $300,000,000 principal amount thereof.

* * * * *

"*Securities issued through bankers, investment houses, and syndicates.*—The growing practice of issuing securities through holding companies which have acted for their subsidiaries has been indicated. Many issues have accordingly been actually disposed of to the general public by bankers, investment houses, or syndicates either at the instance of the issuing companies themselves or the holding companies. Indeed, it has become almost the general practice to thus sell obligations, and of the $300,000,000 of subsidiary securities sold by The North American Co., just referred to (most of which were bonds), all were sold through syndicates, principally headed by Dillon, Read & Co. * * * (*Id.* p. 347).

(2) *Id.* pp. 665, 844, 874.

(3) *Id.* pp. 39–44.

(4) Report of National Power Policy Committee, *supra*, note 3, pp. 5–7.

(5) *Utility Corporations*, Part 72–A, p. 874.

among other things, (1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different States; (2) their service, sales, construction, and other contracts and arrangements are often made and performed by means of the mails and instrumentalities of interstate commerce; (3) their subsidiary public-utility companies often sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce; (4) their practices in respect of and control over subsidiary companies often materially affect the interstate commerce in which those companies engage; (5) their activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies.

We have shown that the mechanics of the Act impose its requirements on interstate holding companies, while leaving unregulated those holding companies which, even though they use the facilities of interstate commerce, are predominantly intrastate in character and within effective state control. We have shown that petitioner, a typical holding company required to register under the Act, is essentially an interstate enterprise, controlling scattered utilities by use of the facilities of interstate commerce, raising capital

in interstate commerce, and through its subsidiaries transporting power in interstate commerce. Finally, we have shown that Congress, with ample support in the materials before it, found that utility holding companies affect interstate commerce in their significant activities.

We turn now to a consideration of the ways in which holding companies have abused interstate commerce, how they have adversely affected and do adversely affect interstate commerce.

B. THE SIGNIFICANT ACTIVITIES OF REGISTERED HOLDING COMPANY SYSTEMS, CARRIED ON IN OR AFFECTING INTERSTATE COMMERCE, ADVERSELY AFFECT THAT COMMERCE TO THE DETRIMENT OF INVESTORS AND CONSUMERS.

Section 1 (b) of the Act recites the definite holding company abuses which the Congress found to be spread and perpetuated by use of the channels of interstate commerce and which experience had demonstrated could not effectively be corrected by state legislation.

The Congressional findings were based on the studies of the Federal Trade Commission and on the Splawn Report, both specifically referred to in Section 1 (b) of the Act; we state below the findings of Congress as to the abuses and make brief reference to the facts found by these studies and by disinterested students of the utility holding company industry.[21]

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[21] It is not possible within the confines of a brief to recite in any detail the evidence disclosed by the Federal Trade Commission study nor can we exhaust the huge catalog of

1. *Abuses with respect to security issues—Section 1 (b) (1)*

Congress found in Section 1 (b) (1) that holding company securities are usually issued and sold without the consent or approval of the states having jurisdiction over the subsidiary public utility companies. At the same time, the characteristics and amounts of holding company securities have a considerable effect on local regulation of operating utilities since they impel the operating companies which are under local regulation to pay maximum dividends and to engage in accounting and financial maneuvers [22] in order to maintain

abuses of holding companies there revealed. *Utility Corporations*, Part 72–A, contains a summary of many of those abuses.

[22] These financial and accounting maneuvers, coupled with the absence of adequate reports and uniform accounts, frequently conceal the unsubstantial foundation of holding company securities and make it impossible for investors in the several states to secure the information necessary for an adequate appraisal of the financial position of the companies. "* * * deceptions arise from an effort to continuously show earnings for dividend purposes and for use in published statements to influence the investing public.

"It has been found that it is quite a common practice among holding companies to overstate earnings and surplus by recording unrealized earnings. The usual ways of doing this are through counting as income intercompany profits, undistributed earnings of subsidiaries, and the erroneous recording of stock dividends, stock rights, etc., received. The creation of surplus by the inflation or write-up of assets has been very general.

"With respect to operating companies, the usual methods of overstating surplus are through inadequate provisions for depreciation, revaluations of fixed assets, and the improper capitalization of expenses." *Utility Corporations*, Part 72–A, pp. 514–515. See also pp. 528–533, 868–870.

dividends to the holding company. In addition, an inordinate resistance to otherwise proper rate reductions is created where operating companies have to support overcapitalized structures of holding companies.[23]

"Holding company securities are often issued upon the basis of fictitious asset values and in anticipation of excess revenues and paper profits" (Sec. 11 (b) (1)) at the expense of the underlying operating companies. The most familiar of these devices was the "write-up," wherein the assets of both operating companies and holding companies were arbitrarily written up in value and watered securities issued against them. The Federal Trade Commission reported, in regard to the limited number of companies studied, that—

> The ledger values of the capital assets of all the companies examined, including both holding and operating companies, contained very large amounts of write-ups. It was found that the combined amount by which the capital assets of all the companies examined were written up in value over cost exceeded 1.4 billion dollars. (*Utility Corporations*, Part 72–A, p. 845).

It is further found that the capital assets of operating companies in holding company systems were written up by 22.1%, of subholding companies by 6.5%, and of holding companies by 9.6%. In

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[23] Bonbright and Means, *The Holding Company* (1st ed. 1932), 166–170.

many cases if the write-ups in operating companies were deducted, little or no equity remained for the common stock; yet it was on the foundation of this common stock that the holding company structure was based and its securities sold to the public.[24]

The effects of write-ups are felt by both investors and consumers, as the Federal Trade Commission stated in its report to Congress:

> The effect of all this issuance of securities against written-up properties may be viewed from two angles, namely, that of the rate payer and that of the investing public. As far as the latter is concerned, it is obvious that the securities owned are not supported by values of properties which appear in the balance sheet of the company issuing such securities. In case of liquidation, it is questionable in many cases whether there could be realized sufficient cash from the sale of the assets of the company to liquidate the securities at their book values. A further effect on the investor is the fact that a failure to earn on excessive security issues and consequently to pay interest or dividends on securities issued (especially in case of heavily written-up properties) has undoubtedly been a principal cause of receiverships and other financial difficulties through which many utility systems are now passing. Practices of this sort have constituted one of the gravest

[24] *Utility Corporations*, Part 72–A, pp. 298–304.

dangers developed during the course of the entire investigation.

As to the rate-paying public, this matter is discussed at some length elsewhere (see ch. V). Suffice it to say here that while in States having utility regulation the usual theory of rate-making presupposes a return based on the actual values of properties, it is unquestionably a fact that the book values have considerable effect on the regulating authorities or complainants in rate cases. This was recognized in a recent decision of the Public Service Commission of the State of New York, in which the following statement was made: "Overcapitalization was not only undesirable from the viewpoint of the security holder, but was most detrimental to the public, for it concealed the true profits and made it appear that rates were reasonable. Such concealment was one of the reasons, if not the principal one in many instances, why companies were overcapitalized." (*Utility Corporations*, Part 72–A, p. 327.)

Most of the write-ups found in the holding and operating companies examined were reflected in security issues and were initiated by the holding-company management. The holding-company management has been generally under strong pressure to operate the controlled companies in such a manner as to earn a profitable return on the security issues, including those issued against the write-ups. This process therefore af-

> fects both the consuming and investing public. * * * (*Id.* at 845.)
>
> * * * In most instances these write-ups were injected by the controlling interests and were often based apparently on the amount of bonds and preferred stocks they thought could be marketed. * * *
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> * * * * *
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> For the most part, all of the various forms of write-ups referred to above were capitalized through security issues, of which those not required for control purposes were sold to the investing public, insofar as possible, thus enabling those initiating such transactions to recover in cash, or in securities of the issuing companies, a substantial portion, or all, of their investment, and in a few instances even more. This had the effect of passing on to the public most of the actual investment in the assets of the operating companies whose properties had been written up in value, or of the subholding companies whose securities had been written up. * * * (*Id.* at 846, 847.)

In short, the presence of holding companies with their typically complex structures and substantial amounts of senior securities has operated to the detriment not only of widely scattered investors but also of consumers of the utility products of the underlying operating companies.

With the erection of holding-company systems on such bases it is not surprising that investors have been seriously harmed. The twin devices

of pyramiding and stock watering worked well as long as rate-making agencies were nonexistent or quiescent and earnings continued to rise; but upon the pricking of the bubble, the leverage worked in reverse [25] and many investors

[25] "Another effect is greatly to multiply the rate of return that the stockholders of the top company can obtain upon their investment in the stock through which they exercise this control, provided that the operating companies are prosperous enough to earn 8 percent [in the hypothetical case there discussed] on the total investment in their businesses. It also has the result of greatly magnifying the adverse effect upon the income accruing to the holder of the top company's securities of a small diminution in the total net income of the operating companies that constitute the bottom layer. A relatively small decline in the total gross income of the operating companies, such as is very likely to happen in an industrial depression and which did happen in the present industrial depression, may wipe out a large part of the income accruing to the first layer of subholding companies and enable them to pay the contractual rates of income on only their senior securities, leaving nothing for the common-stock equities of subholding companies in the next higher layer. Such an event is likely, in an extreme case, to result in bankruptcy of the holding companies that are higher up in the pyramid.

"* * * The common stock of the top holding company of many public-utility pyramids is extremely speculative on account of the extreme 'leverage' exercised on the earnings of the top holding company by comparatively small changes in the earnings of the underlying operating companies. It becomes a favorite stock for speculators and stimulates stock gambling. If the pyramided system falls into the hands of unscrupulous men, the possibilities of manipulation are greatly increased. A highly pyramided system (where any securities of the top holding or subholding companies are sold to the public) is dangerous and has no justification for existence." (*Utility Corporations*, Part 72–A, pp. 161, 162.)

were ruined. Prior to the passage of the Act many holding companies were either in acute distress or in bankruptcy or receivership. The failure of the pyramiding device is illustrated graphically in the fate of investors who placed their funds in "preferred" stocks of holding companies. As of December 31, 1940, preferred stocks of registered holding companies had a total involuntary liquidating value exclusive of arrears of $2,500,000,000; of this total more than half, or $1,440,000,000, were in default. The total accumulated arrears on registered holding company preferred stocks as of that date was approximately $476,000,000.[26]

Even the preferred stocks of *operating* companies in holding company systems were harmed through excessive service charges, excessive common stock dividends, upstream loans (from the operating companies to the holding companies), other extortionate holding company transactions and excessive proportions of senior securities. Of preferred stocks of operating companies in holding company systems totaling $1,700,000,000 at December 31, 1940, approximately $450,000,000 were in default, the arrears aggregating $165,000,000. These figures reveal both the injury which pyramiding has caused and is causing to

[26] These and the following figures on preferred arrearages are taken from official reports of registered holding companies filed with the Commission.

the American investors and the unhealthy and complicated corporate structures which characterize a substantial portion of the industry. They also indicate the urgent need for system rehabilitation and simplification which Congress prescribed in Section 11 (b).[27]

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[27] The great deflation and collapse of holding companies was not occasioned by any serious reduction or collapse of the earnings in the operating companies. The latters' earnings held up rather well through the depression and subsequent years. In fact, since 1929, State Commissions and the Federal Power Commission have been able to obtain rate reductions aggregating millions of dollars. Middle West Utilities, for example, which went into bankruptcy in 1932, actually had greater gross revenues from its electric and gas utilities in 1931 than it did in 1929 (based on figures reported in Moody's *Manual of Public Utilities* (1935)). A substantial proportion of its "earnings" had been previously derived from intrasystem purchases and sales at inflationary prices. As a whole, the electric utility industry had greater gross revenues in 1936 than it did in the year 1929. See *The Electric Light and Power Industry in the United States*, Edison Electric Institute Statistical Bulletin Number 9, 1941, at p. 39. The collapse of pyramided holding company systems, controlling scattered operating companies throughout the United States, can be attributed, therefore, solely to fundamental unsoundness.

As the Federal Trade Commission found, "their weakness was due in a smaller measure to the depression than to unsound intercorporate structure, unsound financial set-up, and in some cases to stupid, reckless, or dishonest practices. The reckless and dishonest ones generally suffered the most, and some of them went into receivership or became bankrupt. Any advantages of the electric and gas utility holding company in actual practice, therefore, were offset by fundamental structural disadvantages, so that in the net result *there were*

The Federal Trade Commission arrived at the generalization that "None of the large holding-company groups appears to have had a suitable capital structure from an investor's standpoint," specifying with respect to petitioner that—

> The North American Co. had outstanding only common and preferred until 1931, when it issued $25,000,000 in debentures. It had an important subholding company with common, preferred, and long-term debt outstanding It had also another large subholding company, in which the majority interest was recently acquired, which had common, preferred, and bonds outstanding, and this subholding company had three important subholding companies of its own with the same classes of securities.[28]

Just as petitioner's system enjoys no immunity from the evils of pyramiding holding company upon holding company, all with debt securities and preferred as well as common shares, so it presents examples of the characteristic holding company tendency to cause its subsidiaries to raise a maximum amount of needed additional capital by selling senior securities, and a mini-

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no demonstrable advantages as regards the investor, even for the better-managed groups, because none of the important ones even closely approximated the possibilities of a thoroughly sound and conservative organization." (*Utility Corporations*, Part 72–A, p. 860. Italics supplied.)

[28] *Utility Corporations*, Part 72–A, p. 859.

mum amount by selling common stock.[29] See, e. g., *Potomac Electric Power Co.*, 8 S. E. C. 30, 36; *Potomac Electric Power Company*, Holding Company Act Release No. 3759, pp. 7, 8 (1942).

2. Dealings not at arm's length—Section 1 (b) (2)

Congress further found that subsidiary public utility companies are subjected to excessive charges for services, construction work, equipment and materials, for the benefit of holding companies or their wholly owned service company subsidiaries. A great number of examples of this practice were disclosed by the Federal Trade Commission, whose studies showed profits to holding companies on servicing of subsidiaries sometimes higher than 190% of the cost of rendering the services.[30]

[29] This is but a natural result of the existence of holding companies which do not own all the securities of subsidiaries, for both leverage and relative voting power are diminished upon sales of common stock to the public by subsidiaries; whereas sales of senior securities, at interest or dividend rates lower than the allowable rate of return, increase leverage and generally do not endanger the holding company's control.

[30] "These examples indicate that the servicing fee has been, either directly or through an affiliate, a substantial source of net income for many of the largest utility holding companies and that this fee has been collected principally and in some cases almost wholly from controlled operating utilities. They also show that the net income from servicing is high and frequently extremely high in relation to cost. It should also be borne in mind that these costs, as regards their neces-

One aspect of excessive service charges was that the sums paid were charged as operating expenses by the operating companies and thus the profits realized on the service charges were in addition to the theoretically fair return on capital permitted the operating company.[31] In this way state regulation of rates was circumvented, since the holding companies and their wholly owned subsidiary service companies were generally incorporated outside the state of regulation, and data on the cost of rendering the services were unavailable to the state commissions.[32]

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sity and genuineness, have not been checked by the Federal Trade Commission, and, if too high, the rates of net income as computed herewith are too low." (*Utility Corporations*, Part 72–A, p. 663.)

[31] "A second source of fee income and possible profit to the holding company [in addition to charges for services which were recorded by the subsidiaries as operating expenses] is the charging of engineering fees in connection with the formulation of plans for additions and betterments to properties, fees for financing, and cost-plus fees on construction. These construction fees, instead of being expenses chargeable directly against operating revenues of the companies serviced, are capitalized when the properties are put into operation, thus increasing the rate base, and also become part of the depreciable property eventually to be covered by depreciation charges against future revenues and profits. In either case it is expected that the fees paid will be ultimately recouped by the operating company through the consumer's meter in subsequent operations." (*Utility Corporations*, Part 72–A, p. 843.)

[32] *Utility Corporations*, Part 72–A, p. 665; 844. As Congress found in Section 1 (b) (2), state regulation was also impeded because service charges were frequently allocated

Investors equally with consumers were injured by excessive service charges. Bondholders and preferred stockholders of operating companies obviously suffer a dilution of their earnings coverage, since service fees, as operating expenses, are paid to the holding company prior to the payment of interest and dividends.[33] Minority stockholders are even more directly injured, since income which might otherwise be paid as dividends to *all stockholders* is diverted to the holding company under the guise of "operating expenses."[34] Holding company security holders, though temporarily benefited by the receipt of unwarranted income, were, paradoxically, injured most of all, since securities were sold to them upon the basis of holding company income temporarily inflated by exorbitant servicing profits.

It is true that Section 13 of the Act provides for the elimination of servicing at a profit, and also for

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among subsidiaries in several states. This conclusion was reached by the Federal Trade Commission. *Utility Corporations*, Part 72-A, p. 874.

[33] *Utility Corporations*, Part 72-A, p. 658, Note 21.

[34] "* * * If by control of the voting stock of the company, expense unproductive to the company is incurred to [the controlling stockholder's] benefit," reported the Federal Trade Commission in relation to profits on servicing, "he will lose as investor in the company's stock, but gain through control of the company. In such case, any minority stockholders lose with no offsetting gain." (*Utility Corporations*, Part 72-A, p. 658, Note 20.)

regulation of the allocation of charges as between companies in holding company systems. However, regulation of this character is at best an empirical process and Congress could properly regard the simplification of holding company systems as a more adequate solution. Apart from this present relationship to Section 11, we advert to the past evils in connection with servicing because the unsound holding company structures dealt with by Section 11 (b) represent in part the capitalization of profits from servicing activities.

The Congress also found an adverse effect on the national public interest and the interest of investors and consumers when subsidiary public utility companies are required to enter into other intrasystem transactions (besides service arrangements) without arm's-length bargaining or the restraint of free and independent competition.

As the Federal Trade Commission found:

> Exaggerated capital structures may result from intercompany sales at large profits within the holding-company group of property, or stocks, whereby the final owner within the group pays exorbitant prices. If the final purchaser of such property or stocks is an operating utility, it may have the effect of increasing the rate base and the rates charged to the consumer, or, if the management proves unsuccessful

in increasing rates, it may leave the purchasing company with a capital structure upon which it cannot pay dividends, and so forth. The ease with which profits may be realized through intercompany sales of securities when there is control through ownership of voting stocks furnishes a temptation that few holding-company managements have been able to resist.

When stocks representing control are disposed of to outsiders, the control which they represent goes with them, and the gain made is on a par with any other capital gain. Where, however, the sale is between two controlled companies of the same group, there can be no independent bargaining. The gain is taken, but the control is retained, and, therefore, there is always a possibility of subsequent repetition of the process. The characteristic effect of such dealings is that they tend to inflate arbitrarily the capital structure all along the line without regard to the sound market values of the securities or other property acquisition.

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The Federal Trade Commission's inquiries have developed numerous instances in which inflation of capital structures through intercompany profits, whether on an arbitrary basis or upon an inflated market value, due to speculation or to actual rigging of the market, during the years prior to 1930, has contributed to present-day financial embarrassments and to many

cases of receiverships of holding companies and their affiliated companies. Thus, intercompany sales within a holding-company group involve various complications and dangerous pitfalls to different interests within the same group and often result in gross misstatements of corporate earnings. * * *

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In their least objectionable use such transactions mean taking up, as intercompany profits, a part, or all, of any real increase or appreciation in value of stocks or properties that may have taken place and that might be realized by outright sale to nonaffiliated interests, and at the same time retaining operating control of the companies. In their most objectionable form they become the means of fraud through false showings of investments and earnings, resulting in the creation of a capital structure that may, sooner or later, collapse like a house of cards. Even though not pushed to this point, they are a distinct disadvantage of holding-company management from the viewpoint of sound financing. Danger of misuse, even by otherwise conservative managements, always lurks in contracts among parties controlled by the same interest. Even where conservatively used there are difficult questions involved arising from the fact that a single economic interest in dealing with itself for profit, and that often minority stock or bondholders have different inter-

> ests in these transactions. There is also the difficult question of determining what appreciation in properties has taken place and what part thereof may ethically, safely, or even legally be taken at any given time as income to meet interest and dividend requirements on capital structures inflated by this and other means. These difficulties constitute very serious drawbacks to the holding-company system and are inherent evils in such inter-company transactions. (*Utility Corporations*, Part 72–A, pp. 864, 865 and 866.)

A striking example of the dangers inherent in the holding company-subsidiary company relationship is *Murphy* v. *North American Light & Power Co.*, 106 F. (2d) 74 (C. C. A. 2.) In that case, The North American Company had contracted to underwrite over a five-year period certain offerings of common stock by its subsidiary, North American Light & Power Company. After three years, when it became evident that the common stock was of dubious value, North American tried to take advantage of an escape clause. In exchange for the $4,000,000 of cash it was required to pay to Light & Power in the last two years it took back notes, ranking ahead of the public preferred stockholders, rather than common stock, which ranked junior to them. It was left for derivative suits by public preferred stockholders to force North American to adhere

to its contract and take common stock rather than the notes.

We do not wish our reference to the *Murphy* case to raise an inference that the management of North American did not act in good faith, for the *Murphy* case did not turn on that question. Our purpose is to indicate by concrete reference the potentiality of abuse ever present in dealings between the typical holding company and its subsidiaries.

Absence of arm's-length dealing in banking relations has also been typical. It is noteworthy that investment bankers connected with the systems have played a central role in the organization and expansion of holding companies. The Federal Trade Commission found that—

> No large holding-company structure has grown to its present size without the aid of investment bankers, and it is also probably true that not many of the present holding-company structures have developed entirely without opposition from more or less powerful competitive banking groups. In consequence, almost every important holding-company group has more or less close business relations with certain investment bankers and, together with such banking interests, is more or less on the alert to forestall attempts of other holding-company managements, assisted by competing investment bankers, to encroach upon its control. The resulting situation is one in which

> there is great pressure on holding-company managements to give a great deal of attention to the desires and alignments of investment bankers in the formation and operation of holding-company groups. Professional managements apparently often give greater attention to the counsel of bankers than to the interests of widely scattered stockholders who are the equitable owners of the company so managed. (*Id.*, p. 75.)

In a number of instances in the course of the enforcement of the Act, the Securities and Exchange Commission has found that investment bankers stand in such relationship to registered holding company systems that there is liable to be an absence of arm's-length bargaining with respect to transactions between them. See *The Dayton Power and Light Company,* 8 S. E. C. 930, affirmed *sub nom. Morgan Stanley & Co., Inc.* v. *Securities Exchange Commission,* 126 F. (2d) 325 (C. C. A. 2); *Blair & Co., Inc., et al.,* Holding Company Act Release No. 4057 (1943).

These circumstances underlie the findings of the National Power Policy Committee that "fundamentally, the holding company problem always has been, and still is, as much a problem of regulating investment bankers as a problem of regulating the power industry."[35]

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[35] Report of National Power Policy Committee, *supra,* Note 3, p. 6.

3. *Control of operating companies through disproportionately small investment—Section 1 (b) (3)*

It is evident from the materials we have quoted that one of the characteristics of holding company systems is the control which they afford the junior security holders of the top holding company over huge utility empires. As the Federal Trade Commission found—

> The effect of such pyramiding is to multiply greatly the control that can be exercised by the dominant parties through their personal resources. For example, in the illustration just given, an investment of $1 in common stock of Corporation Securities Co. of Chicago would exercise control over about $2,000 invested in properties of some of the operating companies at the bottom of the pyramid. It seems very unsafe to have any form of pyramiding which has such a financial basis, not only on account of the excessive concentration of control over immense masses of property but also because of the opportunity it offers to financial adventurers to have too much influence over the general economic interests of the country. (*Utility Corporations*, Part 72–A, p. 161.)

The National Power Policy Committee reported:

> By the pyramiding of holdings through numerous intermediate holding companies and by the issue, at each level of the struc-

ture, of different classes of stock with unequal voting rights, it has frequently been possible for relatively small but powerful groups with a disproportionately small investment of their own to control and to manage solely in their own interest tremendous capital investments of other people's money. And the ownership of the stock of operating companies is but one of many devices by which a few clever men have woven the amazing network of control and influence with which they have enveloped and entangled large sectors of the gas and electric utility industry. Voting trusts, interlocking directors and officers, management contracts, the control of proxies, and other means, all have been facilely used to bring about a concentration of control in fewer and fewer hands. (*Supra,* note 3, pp. 4, 5.)

4. *Lack of integration and coordination of operating properties and lack of economies—Section 1 (b) (4)*

Another general characteristic of the holding company is the extreme degree of geographic dispersal of its subsidiaries. This arose largely from the fact that during the period of holding company expansion there was a mad scramble to buy operating properties wherever they might be bought and regardless of price. [36]

[36] The attitude of the competitors in utility empire building has been described in Bauer & Gold, *The Electric Power Industry* (1939), p. 152, by quoting the reported reply of

In this connection, the National Power Policy Committee found:

> The growth of the holding company systems has frequently been primarily dictated by promoters' dreams of far-flung power and bankers' schemes for security profits, and has often been attained with the great waste and disregard of public benefit which might be expected from such motives. Whole strings of companies with no particular relation to, and often essentially unconnected with, units in an existing system have been absorbed from time to time. The prices paid for additional units not only have been based upon inflated values but frequently have been run up out of reason by the rivalry of contending systems. Because this growth has been actuated primarily by a desire for size and the power inherent in size, the controlling groups have in many instances done no more than pay lip service to the principle of building up a system as an integrated and economic whole, which might bring actual benefits to its component parts from related operation and unified management. Instead, they have too frequently given us massive, overcapitalized organizations of ever-increasing

Samuel Insull to sharp protests at the price offered for a particular property:

"Hells Bells! I am not paying for the property, but for location. You can't pay too much when you figure what you can take out of the property in the future."

complexity and steadily diminishing coordination and efficiency.[37]

The scramble of rival holding company systems to acquire local operating utilities has resulted in undesirable operating conditions. The National Power Survey Map, "Service Areas of Principal Electric Utility Systems in the United States" (1935), published by the Federal Power Commission, reveals that operating properties owned by rival holding companies stretch out across territories in a crazy-quilt fashion, irrespective of the power needs of the area served and the needed integration of operating properties.

The results of gerrymandering by rival holding companies' acquisition of utility properties has deterred regional integration, has made power more costly, and has blocked the proper coordination of power resources. In many areas, rival systems have checkmated each other's possibilities of integrating adjacent properties and have thus prevented the most efficient utilization of the power resources of the territory. Each jealously guards its own preserve and will not permit the other to coordinate the utility assets of the area into an integrated system. Students of the utility industry point out that there has been a country-wide misintegration of generation and transmission assets. There has been—

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[37] *Supra*, note 3, p. 5.

> * * * not only uneconomical location and proportionality of generating stations, with consequent waste and duplications, but there have been particularly excessive, badly located, duplicating, overlapping and overcostly transmission lines. These were mostly planned * * * for system advantages, according to dictates of absentee control. The net result is poor economy, unnecessarily high cost of generation, haphazard interconnections, and wasteful transmission. And in most states there are extensive sections without adequate connections and with unjustifiably high cost of power.[38]

The resultant sprawling character of holding company systems raises grave doubt whether there are economic advantages in control of such properties from the headquarters of a holding company in a remote financial center.

The fundamental objectives of Section 11 in this respect find support in the recommendations of the most thoughtful students of public utilities both in this country and abroad. The Committee on Electricity Distribution, appointed by the British Ministry of Transport, reported in 1936 that the maximum benefits from centralized holding company control occur where the utility properties controlled are physically contiguous, and that such maximum benefits cannot be realized in the

[38] Bauer and Gold, *The Electric Power Industry* (1939), p. 171.

association under one ownership and management of properties serving widely separated areas. The British Committee stated:

> It will be apparent that, potentially at least, the system of Holding Companies offers certain of the advantages which we envisage as a result of the amalgamation of the smaller undertakings, such as the benefit of central management, centralized purchasing of materials, provision of adequate financial resources, etc. The evidence which has been placed before us shows that, in fact, Holding Companies have, to a considerable extent, achieved the advantages just mentioned. They have also, in planning coordinated development of their respective groups, in some degree overcome the disabilities involved in the physical separation of the various controlled undertakings.
>
> *On the other hand, the question of the physical contiguity of undertakings must be of major importance in relation to management and technical planning and development, and the maximum benefits of centralized control cannot be realized by the association under one ownership and management of undertakings covering widely separated areas.*
>
> While, in general, substantial economies can be effected by central purchasing being carried out by one controlling organization on behalf of a number of small subsidiary Companies, there is an economic limit to

the advantage accruing from large scale purchasing. We are not satisfied that any considerable benefits accrue to the larger subsidiary companies by reason of purchases being carried out by a central organization rather than by these larger subsidiaries themselves. (Report of the Committee on Electricity Distribution, May 1936, Sections 287–289.) [Italics supplied.][39]

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[39] The Splawn Report recommended to Congress that holding companies be abolished completely. See House Report No. 827, part 2, 73d Cong., 2d sess., at VII.

See also Bonbright and Means, *The Holding Company* (1932), at p. 222:

"A sound financial structure, a well integrated system of physically connected utility properties, and a scheme of management services which assures to the public, rather than to the stockholders, the primary advantage of centralized management and control, are more necessary for the country than is the continuance of hectic efforts on the part of the dozen large utility groups to expand their properties at all costs."

Barnes, *The Economics of Public Utility Regulation* (1942), concluded (p. 671):

"When the Public Utility Holding Company Act became law in 1935, the holding company system in the electric and gas utility industries was so intricate that effective regulation was impossible, so complex that investors could not accurately appraise the worth of their securities, so irrational that the potential economies of centralized operation and management could not be realized in practice, and so unnecessarily costly that the interests of consumers in low rates were prejudiced. In the interests of investors and consumers, and as a prerequisite to effective regulation, it was essential to provide for a simplification of the uneconomic complexities and an integration along rational engineering lines. * * *"

C. O. Ruggles, professor of public-utility management at the Harvard Business School and a recognized authority whose professional expertness and integrity have been acknowledged by holding-company representatives (Hearings before the Committee on Interstate Commerce, United States Senate, 74th Congress, 1st Session, on S. 1725, pp. 1009–1010), has written:

> Careful students of public utilities have realized for some time that satisfactory results could not be obtained through the management of far-flung operating companies by highly centralized, complex intercorporate organizations. It is a regrettable fact that the management of some of these super-holding companies have had very little real interest in the prosaic business of furnishing public ultility service. They have instead been primarily interested in the issue and sale of securities; and, for that reason, they have sought a form of organization which made it difficult, if not impossible, to check their accounts or subject their management of operating companies to proper supervision and control. * * * Complex intercorporate organizations which are primarily interested in the sale of public ultility securities ought to be displaced by integrated systems of such a size that the fullest possible economies may be realized without the evil effects of highly centralized control. (Ruggles, Public Utility Management and

Regulation (1935), 14 Harv. Bus. Rev. 59, at 59, 71.)

Even if substantial economies could be realized by holding company servicing of scattered properties, the dangers accompanying the resultant concentration of power in the hands of a small group might well outweigh any such relatively small dollars-and-cents benefits. In this connection, the National Power Policy Committee concluded that—

> While the distribution of gas or electricity in any given community is tolerated as a "natural monopoly" to avoid local duplication of plants, there is no justification for an extension of that idea of local monopoly to embrace the common control, by a few powerful interests, of utility plants scattered over many States and totally unconnected in operation. Such intensification of economic power beyond the point of proved economies not only is susceptible of grave abuse but is a form of private socialism inimical to the functioning of democratic institutions and the welfare of a free people.[40]

5. Impairment of state regulation

We have referred above to several of the ways in which holding companies obstruct effective public regulation of utility companies which they control—such as write-ups, excessive service

[40] *Supra*, note 3, pp. 7, 8.

charges, and sales of securities to affiliated bankers. In fact, the obstruction of State regulation by holding companies is pervasive.

As the Report of the National Power Policy Committee points out:

> Holding-company operations are too extensive, State commission power and funds too limited, to make thorough and effective State action possible. And usually the holding companies have purposely arranged their organization and operations to keep out of reach of State regulation; their lawyers have challenged the jurisdiction of such regulation. Generally a holding company itself is incorporated outside the States in which its operating companies are located and carefully does not do business within those States in a manner which will give State commissions technical power to reach the books and records of the holding company. Even if obtainable, however, such books and records will be comparatively unintelligible and even misleading until uniform accounting methods are made compulsory. There is the further difficulty of allocating the appropriate proportion of the cost of holding-company activities to its subsidiaries in a particular State, coupled with needless waste in having the process duplicated in State after State. These difficulties of State agencies are so fundamental that not even interstate compacts—assuming they could be evolved—can make State regulation practically effective with-

out supplemental help from a Federal law. (*Supra*, note 3, pp. 7, 8.)

Senator Brown of New Hampshire stated on the floor of the Senate:

> Mr. President, I have had some experience with State regulation of utilities. I served upon the New Hampshire Public Service Commission for more than seven years. * * *
>
> * * * * *
>
> About half a dozen foreign holding companies now completely dominate and control the power industry throughout the length and breadth of the State of New Hampshire. * * *
>
> * * * * *
>
> The confusing nature of the intercorporate relationships in a holding-company system hopelessly complicated the task of the State commission. The subsidiaries were all one company when it suited the holding company managers' purposes and they were separate and distinct entities with sacred constitutional rights whenever there was a chance of escaping the arm of the law.
>
> Our commission could never even be certain as to the number of holding companies doing business in the State, because it is almost impossible for a State commission to discover the holding company or companies controlling an operating company, providing the representatives of the controlling company are not d i s p o s e d to

divulge the truth of the matter. More than once have I seen the person in charge of an operating company claim and insist that he did not know where the company was located which was over him; did not know the name of his boss; and did not know where he lived.

* * * * *

In 1930, after repeated unsuccessful efforts to obtain the facts informally with relation to a holding-company system having operating companies in New Hampshire, the regulatory body of which I was a member instituted a formal investigation for the purpose of gaining information as to whether or not certain operating companies in our State, controlled by a holding-company system which is doing business over a considerable part of this country, were complying with the law and orders of the commission, and to obtain evidence in detail as to the capitalization, franchises, and manner in which the lines and property controlled by this holding-company system were managed and operated. This investigation, with the court procedure entailed, covered some two years, and certain phases of the case are now before the Supreme Court, more than five years after initial steps for investigation were taken. (79 Cong. Rec. 8705, 8706.)

An example of efforts to subvert local authority was revealed by the conviction in 1942 of the Union Electric Company of Missouri and one of its top

officers for violating the corrupt practices section of the Act, Section 12 (h). The company had raised a $600,000 slush fund by obtaining kickbacks from lawyers, contractors, etc., and a substantial portion of the money was traced to bribes paid to local officials as well as to political contributions in violation of the Act. *United States* v. *Union Electric Company of Missouri and Louis H. Egan,* D. C. E. D. Mo., No. 31882, pending on appeal. See *Boehm* v. *United States,* 123 F. (2d) 791 (C. C. A. 8), certiorari denied, 315 U. S. 800, rehearing denied, 315 U. S. 828.

As the Senate Committee on Interstate Commerce said in reference to the Act:

> In considering this point the President's message on this point should be kept in mind:
>
> "Where the utility holding company does not perform a demonstrably useful and necessary function in the operating industry and is used simply as a means of financial control, it is idle to talk of the continuation of holding companies on the assumption that regulation can protect the public against them. Regulation has small chance of ultimate success against the kind of concentrated wealth and economic power which holding companies have shown the ability to acquire in the utility field. No Government effort can be expected to carry out effective, continuous, and intricate regulation of the kind of private empires within the Nation which the holding-

company device has proved capable of creating.

"Except where it is absolutely necessary to the continued functioning of a geographically integrated operating utility system, the utility holding company with its present powers must go."

The almost impossible struggle which State regulatory commissions have waged against the giant holding companies is proof of the President's position. (Italics supplied.) (S. Rep. 621, 74th Cong., 1st sess., p. 4.)

Private utilities with their legalized monopolies are chartered to serve public ends. A far-flung disjointed system is independent and absentee so far as any particular community in its system is concerned. Its management has the problems of no one community for its exclusive consideration. It derives a great portion of its power and its profits from outside sources over which the community has no control. It can never be successfully regulated by the community it serves. It is a breeder of bad public relations.

An operating system whose management is confined in its interest, its energies, and its profits to the needs, the problems, and the service of one regional community is likely to serve that community better, to confine itself to the operating business, to be amenable to local regulation, to be attuned and responsible to the fair demands of the public, and more often to get along with the

> public to mutual advantage. A regional system, with each company confined to consolidation of its own territory, will offer no chance for the territorial raids at fantastic prices with which for fifteen years competing holding company systems disturbed the operating business. Essentially local systems will tend to operate utilities rather than to play with high finance; and essentially local enterprise is far less likely to accumulate a disproportionate amount of political and economic power. (*Id.* pp. 11 and 12).

One must also note the adverse effect on local regulation caused by the enormous concentration of power in holding companies. For example, expert testimony is frequently adduced in proceedings before local regulatory commissions on such matters as rates, accounts, and service; and this is affected by the concentration of power. The Federal Trade Commission made the following comments in regard to the "independent" engineers, accountants, and other experts who testify in such proceedings:

> In general, these practices of the holding-company groups have tended to transfer from the independent consulting professional groups working on a fee basis, many expert engineers, accountants, etc., to the salary rolls of a holding-company group and have sometimes caused other such experts, ostensibly in independent practice,

to be largely dependent upon one of these large groups.

The opportunity for a wide range of activity on a consultant basis, conducive to professional independence of attitude, has been thus greatly limited, if not practically destroyed, in the large and important public-utility fields. This is possibly one of the serious results of concentration of control of large activities under one management in that it has given such control a dominating influence over professional attitudes. * * * (*Utility Corporations,* Part. 72–A, p. 697.)

It is quite evident that the consolidation of numerous operating units of business, previously owned and managed by unrelated individuals or small groups, into a relatively few large controlling holding companies, with volumes of business justifying establishing salaried staffs of engineers, accountants, etc., has seriously limited the field of activity of consultants. Instead of 10 jobs available from 10 independent owners, the 10 jobs are reduced to only 1 or 2. The independence of the outside consultant necessarily is influenced by such a situation, especially in matters of controversy of interest between management, investors, and consumers which arise in appraisals of public utilities.

* * * * *

Though it may be recognized that consolidations of public utilities and establish-

> ment of holding companies may in some cases have brought to bear higher grade skill at less actual cost for many operating properties, it seems necessary to consider that independence of mind on many matters and availability of experienced and independent consultants have been greatly diminished thereby. (*Id.*, p. 815.)
>
> * * * It is noteworthy that, with the growth of great holding companies, the independent professional engineers in the field of electric and gas engineering have become very scarce, and their main dependence for professional work is on salaried jobs with great corporations. Independent and expert engineering opinion is, therefore, more difficult to obtain now than formerly. (*Id.*, p. 873.)

In summary, the Federal Trade Commission found as follows:

> The highly pyramided holding-company group represents the holding-company system at its worst. It is bad in that it allows one or two individuals, or a small coterie of capitalists, to control arbitrarily enormous amounts of investment supplied by many other people. In such a situation few men could be relied on to devote their attention to prudent management of the operating companies, because the speculative element is so overwhelming. It tends, apparently, to make them (1) neglect good management of operating companies,

especially by failing to provide for adequate depreciation; (2) exaggerate profits by unsound, deceptive accounting; (3) seek exorbitant profits from service fees exacted from subsidiaries; (4) disburse unearned dividends, because the apparent gains, so obtained, greatly magnify the rate of earnings for the top holding company; and (5) promote extravagant speculation in the prices of such equity stocks on the exchanges. Such concentration of control, even without that speculative pressure, appears objectionable as a matter of sound national welfare. The pyramid is bad also because it involves the sale to the public of preferred and common stocks of holding or subholding companies which have an unusually speculative character—what are aptly called "high-leverage stocks"—although many experienced, if not wise, investors have hitherto regarded some of them as of superior merit, apparently because of the magnitude of the business they controlled. The extreme danger in which such stocks would stand in case earnings declined much below the normal rate (in spite of the warnings uttered by this Commission 8 years ago) have not been understood or believed. But, on the other hand, a sharp distinction should be made between such pyramided holding companies and the single holding company issuing only common stock and owning all of the common stocks of its operating subsidiaries, which under favorable conditions may deserve a

> rating as "business man's investment." Finally, the exaggerated importance to the top holding company of comparatively small differences in the profit of the operating companies greatly enhances the incentive of the holding company to increase such profits, or to obtain a revenue through the exaction of service and other fees in addition to the ordinary revenue by way of dividends. (*Id.*, p. 860.)

These abuses of holding companies, found by the Congress in Section 1 (b) and fully disclosed in the data before the Congress, find their climax in their detrimental effect on consumers and investors. Consumers are harmed by virtue of the strong tendency of many holding company practices to limit rate reductions and impede state rate regulation. Investors are injured because of the adverse effects of holding company structures and practices on values and prices of securities.

The ultimate conclusion of the Federal Trade Commission was that—

> The cumulative effect of some of these abuses undoubtedly resulted in the maintenance of higher than reasonable rates to the consumer and unfavorably affected the value of the securities in the hands of many investors. (*Id.*, p. 882.)

These are the evils and abuses which Congress sought to eliminate. Congress found that these evils and abuses are spread and perpetuated by the business activities carried on by utility hold-

ing companies through interstate commerce. Cf. *Utility Corporations*, Part 73–A, pp. 31–36, 41–58, 205–218.

The concern of Congress over these abuses stems from the fact that much of the power and gas involved is sold in interstate commerce, that huge additional amounts are sold to those producing in and for the commerce, that holding companies raise capital for themselves and their subsidiaries by selling securities in interstate commerce, that those securities are constantly bought and sold in interstate commerce, frequently on national securities exchanges, and that national intervention was required if these activities were adequately to be dealt with in the interest of investors and consumers.

C. CONGRESS HAS POWER UNDER THE COMMERCE CLAUSE TO REGULATE REGISTERED HOLDING COMPANIES BY ELIMINATION OR APPROPRIATE LIMITATION AS PROVIDED IN SECTION 11 (B)

At the outset of the discussion of the commerce power, two preliminary observations should be made. The first is that in view of the extensive Congressional study of public utility holding companies, the findings of Congress, and the provisions of the Act itself, the burden rests on petitioner to establish that no rational foundation exists for concluding that Section 11 (b) (1) is a legitimate exercise of the commerce power as applied to petitioner.[41] It is submitted that this

[41] See, e. g., *United States* v. *Lowden*, 308 U. S. 225, 239, 240; *Stafford* v. *Wallace*, 258 U. S. 495, 521.

burden has not been assumed, much less discharged.

The second observation to be made is that the Act, and Section 11 (b) in particular, are in the conservative tradition of federalism. The Act as a whole exhibits a careful regard for the preservation of local regulation of local utility operations.[42]

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[42] Section 6 (a) regulates the issuance and sale of securities by registered holding companies and their subsidiaries, but an exemption from the provisions of Section 6 (a) is provided in Section 6 (b), in the case of a security issued or sold by a subsidiary company of a registered holding company "if the issue and sale of such security are solely for the purpose of financing the business of such subsidiary company *and have been expressly authorized by the State commission of the State in which such subsidiary company is organized and doing business* * * *." [Italics supplied.] Section 9 (a) regulates the acquisition of utility assets by registered holding companies and their subsidiaries, but an exemption is provided in Section 9 (b) where a state commission has expressly authorized an acquisition of utility assets by a public utility company. Where common ownership of competing electric and gas facilities is unlawful under state law or must receive state commission approval, under Section 8 the holding company device may not be used to circumvent such state laws. In Section 11 (b) (1) it is provided that the utility operations of a holding company system must be confined to a single integrated public utility system with provision for the retention of additional integrated public utility systems only if three standards are met, one of which is that "(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or *the effectiveness of regulation.*" [Italics supplied.] An integrated public utility system, under Section 2 (a) (29), may not be so large as to impair

It has been pointed out (*supra*, pp. 63–71) that one of the serious abuses characteristic of far-flung holding company systems has been the impairment of local regulatory control. Section 11 (b) is designed to strengthen local control by restoring to the states the practical and legal power to cope with important aspects of utility operations. This is not only its effect, but was its deliberate purpose. The Senate Committee Report stated (S. Rep. 621, 74th Cong., 1st sess., p. 11):

> As has been pointed out above, the purpose of section 11 is simply to provide a mechanism to create conditions under which effective Federal and State regulation will be possible. It is therefore the very heart of the title, the section most essential to the accomplishment of the purposes set forth in the President's message.

The use of the commerce power to achieve this objective is, of course, a familiar exercise of national power in the interest of a working federal-

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effective regulation. Under Section 18 (b) the Commission is given the power to conduct investigations "at the request of a state commission" and several states have had occasion to receive this benefit, *New England Power Service Company*, Holding Company Act Release No. 3135 (1941); *American Water Works and Electric Company, Inc.*, Holding Company Act Release No. 4085 (1943). As regards jurisdiction of the Commission over accounts, Section 20 (b) provides that the Holding Company Act does not relieve a public utility company of the duty of keeping any accounts which may be required to be kept by a state law or by a state commission, and any accounting requirements imposed by the Commission shall not be inconsistent with state requirements. See also Section 13 (d).

ism. *Kentucky Whip & Collar Co.* v. *Illinois Central R. Co.*, 299 U. S. 334; *In re Rahrer*, 140 U. S. 545; *Clark Distilling Co.* v. *Western Maryland Ry. Co.*, 242 U. S. 311; *United States* v. *Hill*, 248 U. S. 420.

Thus in the present Act, Congress has exercised its power in the interest both of the states and the nation. The interstate commerce which Congress is here seeking to foster and protect has many important aspects. In general, however, these aspects may be subsumed under two main categories: (a) the interstate transmission of electric energy and gas, its distribution to enterprises in interstate commerce, and the rational interstate coordination of utility resources; and (b) the interstate functions of holding companies in the marketing of securities, exercising of control, and performance of services by one member of a system for others. In both these major aspects the essential activities of the holding company system are subject to national control.

It cannot be questioned that the interstate transmission of electricity is a subject within the regulatory power of Congress. This is true whether the transmission is for sale to independent or affiliated companies or is for sale to ultimate consumers.[43] *The Pipe Line Cases*, 234 U. S. 548;

[43] The Act does not regulate local retail rates, and it is unnecessary to consider the respective power of the states and national government in that regard. Cf. *East Ohio Gas Co.* v. *Tax Commission of Ohio*, 283 U. S. 465.

Pennsylvania Gas Company v. *Public Service Commission*, 252 U. S. 23. Indeed, the power of Congress does not depend at all upon an interstate transaction of sale. As this Court pointed out in *United States* v. *Hill*, 248 U. S. 420, 424: "The transportation of one's own goods from State to State is interstate commerce, and, as such, subject to the regulatory power of Congress. *Pipe Line Cases*, 234 U. S. 548, 560." Interstate transmission is as much within the power of Congress as the function of radio broadcasting; "By its very nature," to adopt the language of this Court in *Fisher's Blend Station, Inc.* v. *Tax Commission*, 297 U. S. 650, 655, it "transcends state lines and is national in its scope and importance—characteristics which bring it within the purpose and protection, and subject it to the control, of the commerce clause." The authority under the commerce clause is properly called into play for the protection and fostering of such commerce, and for the prevention of the spread of injury to persons in the several states by means of such commerce. The injury may, of course, be financial no less than physical. The injury may be done to consumers no less than to competitors. This is plain under the decisions involving pure food and drug legislation and the antitrust laws. *Hipolite Egg Co.* v. *United States*, 220 U. S. 45; *McDermott* v. *Wisconsin*, 228 U. S. 115; *Northern Securities Co.* v. *United States*, 193 U. S. 197. And the power

of Congress may be directed at the financial practices and corporate structure of agencies of interstate transmission in the interest of services which they render. Cf. *Dayton-Goose Creek Railway Company* v. *United States*, 263 U. S. 456. The healthy conduct of interstate commerce in gas and electricity may not be impaired by the co-existence of intrastate activities on the part of those conducting that commerce. *Delaware, Lackawanna & Western R. R.* v. *United States*, 231 U. S. 363, 370.

In addition, as stated above, the interstate business of holding companies such as petitioner, viewed as a far-flung enterprise for the marketing of securities, the maintenance of control, and the rendering of services and assistance to affiliated companies, brings it within the reach of the commerce clause. In *Electric Bond & Share Company* v. *Securities and Exchange Commission*, 303 U. S. 419, the Court described the manifold interstate activities of the system, outlining not only the interstate transmission of energy but also the performance of services and rendering of assistance to subsidiaries and the distribution of securities (pp. 432–433); and the Court, without having to pass on the permissible scope of regulation, concluded that the members of the system bore a "highly important relation to interstate commerce and the national economy" (p. 441)."

"The essentially interstate character of utility holding company activities, and the necessity of federal intervention,

Similarly, sales of power and gas to those producing for and in interstate commerce affect that commerce. *National Labor Relations Board* v.

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were thus described by Senator Borah in the debates on the present Act:

"The activities of some of these holding companies have been perfectly lawless. They have been in disregard of the interests of those to whom they were selling their stocks and their securities. They have been in disregard of the interests of the community and they have been in disregard of the interests of the entire country. It is by reason of those things that it became absolutely necessary that the Congress of the United States deal with the subject matter covered by the bill before us.

"We certainly could not permit those things to go on indefinitely. We certainly could not permit such practices to prevail as a permanent proposition; somebody had to deal with the question. I know of nobody to deal with such companies as those which spread across State lines and control subsidiaries acting in different States of the Union except the Congress of the United States.

"* * * it seems to me that a company which owns 30 or 40 or even 5 or 6 subsidiary companies and affiliates, which subsidiary companies are operating in different States, and which this holding company must control by utilizing the means of transportation or the means of communication between the different States— a holding company which conducts the business, determines the policy, and directs the course of these different subsidiary companies, and does it through employing the channels either of the mail or of the telephone or of the telegraph—must necessarily be under the control of the National Congress, or under the control of nobody whatever. They would be in a 'no man's land' if that were not true." (79 Cong. Rec. p. 9049.)

That no such hiatus exists under the Constitution is made clear by this Court in *United States* v. *Wrightwood Dairy Corp.*, 315 U. S. 110, 118.

Consolidated Edison Company, 305 U. S. 197. Furthermore, holding company systems, through their concentrated control of buying power, substantially affect the flow in interstate commerce of coal, equipment, and other commodities of which they are important consumers.

The essentially interstate character of the business of petitioner is not significantly different from that of the news gathering and news disseminating agency whose operations were considered in *Associated Press* v. *National Labor Relations Board,* 301 U. S. 103, 128–129. There it was contended that the Associated Press was not subject to Congressional authority because it was not engaged in business for profit; because it sold information only to its members; because news reports are not a subject of commerce; and because title to the news remained in the Association during transmission. These contentions were rejected by the Court, in an opinion which emphasized that interstate communication of a business nature is interstate commerce within the regulatory power of Congress. The Court said (pp. 128–129):

> It [The Associated Press] is an instrumentality set up by constituent members who are engaged in a commercial business for profit, and as such instrumentality acts as an exchange or clearing house of news as between the respective members, and as a supplier to members, of news gathered through its own domestic and foreign activi-

ties. These operations involve the constant use of channels of interstate and foreign communication. They amount to commercial intercourse, and such intercourse is commerce within the meaning of the Constitution. [*Gibbons* v. *Ogden*, 9 Wheat. 1, 189.] Interstate communication of a business nature, whatever the means of such communication, is interstate commerce regulable by Congress under the Constitution. [*Pensacola Telegraph Co.* v. *Western Union*, 96 U. S. 1, 9, 10; *Federal Radio Comm'n* v. *Nelson Bros. Co.*, 289 U. S. 266, 279; *International Textbook Co.* v. *Pigg*, 217 U. S. 91, 107; *Indiana Farmer's Guide Publishing Co.* v. *Prairie Farmer Publishing Co.*, 293 U. S. 268, 276.] This conclusion is unaffected by the fact that the petitioner does not sell news and does not operate for profit [*United States* v. *Hill*, 248 U. S. 420; *United States* v. *Simpson*, 252 U. S. 465], or that technically the title to the news remains in the petitioner during interstate transmission. [*Pipe Line Cases*, 234 U. S. 548, 560.] Petitioner being so engaged in interstate commerce, the Congress may adopt appropriate regulations of its activities for the protection and advancement, and for the insurance of the safety of, such commerce.

It is important to recall that the use of the facilities of interstate commerce by petitioner is not casual, incidental, or collateral. The use is of the essence of its business. It is not an ap-

pendage, but the very bone and sinew of its enterprise. The abuses and opportunities for abuse which Congress found to be inherent in the utilities holding company system depend upon the employment of interstate commerce. They become a matter of national concern because they are spread and perpetuated by means of interstate commerce. In these circumstances Congress was at liberty to exercise its power under the commerce clause in an effort to eliminate or ameliorate those abuses. That effort was properly made in the interest of investors as well as of consumers. Cf. *New York Central Securities Corp.* v. *United States,* 287 U. S. 12; *Securities and Exchange Com'n* v. *Crude Oil Corporation of America,* 93 F. (2d) 844 (C. C. A. 7) (Securities Act of 1933); *Coplin* v. *United States,* 88 F. (2d) 652 (C. C. A. 9) (same). The power of Congress to prevent the spread of harm, whether it be moral or physical or financial, through the use of interstate commerce, was succinctly described by this Court in *Brooks* v. *United States,* 267 U. S. 432, 436–437:

> Congress can certainly regulate interstate commerce to the extent of forbidding and punishing the use of such commerce as an agency to promote immorality, dishonesty or the spread of any evil or harm to the people of other States from the State of origin. In doing this it is merely exercising the police power, for the benefit of

> the public, within the field of interstate commerce. * * *

The power of Congress is not limited to forbidding the interstate movement by which injurious practices are given national effect. Such a power has, of course, been frequently exercised. See *Kentucky Whip & Collar Co.* v. *Illinois Central R. Co.*, 299 U. S. 334. For, as was said in *Electric Bond & Share* v. *Securities and Exchange Commission*, 303 U. S. 419, 442, "When Congress lays down a valid rule to govern those engaged in transactions in interstate commerce, Congress may deny to those who violate the rule the right to engage in such transactions." But this is only one kind of sanction which Congress may employ. Congress may elect to reach the evil at its source. This is an equally familiar sanction. *Wickard* v. *Filburn*, No. 59, present term; *United States* v. *Darby*, 312 U. S. 100; *National Labor Relations Board* v. *Jones & Laughlin Steel Corp.*, 301 U. S. 1; *Chicago Board of Trade* v. *Olsen*, 262 U. S. 1; *Stafford* v. *Wallace*, 258 U. S. 495. Indeed, it is the very remedy which Congress employed half a century ago in the antitrust laws and which was early applied to the railroad holding company. *Northern Securities Co.* v. *United States*, 193 U. S. 197. The remedy of dissolution or divestment has frequently been applied under the antitrust acts, and under the commodities clause of the Hepburn Act. *Standard Oil Company* v. *United States*, 221 U. S. 1; *Continental Ins. Co.* v. *United States*, 259

U. S. 156; *United States* v. *Lehigh Valley Railroad*, 220 U. S. 257; *United States* v. *Delaware, Lackawanna & Western Railroad Company*, 238 U. S. 516.

The Congress might have dealt with the problem of interstate utility holding companies by abolishing them entirely or prohibiting their interstate transactions. Instead, the solution adopted by the Congress in the Act was the more moderate one of their elimination if they cannot meet the standards of Section 11 (b) of the Act. The standard in Section 11 (b) (1) is the limitation of the operations of a holding company system to a single integrated public utility system with provision for the retention of additional systems only if they are relatively small, located close to the single system and unable to operate economically under separate management without the loss of substantial economies; similarly, other holdings may be retained only if their retention is related to the operations of the retained utility properties. The standard in Section 11 (b) (2) permits the continued existence of holding companies only where they perform some useful function and do not represent pyramiding, where they have simple structures and are not the cause of unfair or inequitable distribution of voting power.

This classification of permissible and nonpermissible holding company structures is a reasonable one. It represents a relaxation of the policy of elimination in order to permit certain advan-

tages to be realized by what Congress regarded as a legitimate limited employment of the holding company device.

Moreover, this relaxation is itself related to the regulation of interstate commerce. Holding companies permitted to exist under the limitations of Section 11 (b) are localized companies of simple structure in which the likelihood of abuses burdening and obstructing interstate commerce is relatively small. The provisions of Section 11 (b) which permit the continued existence of such companies are thus reasonably related to prevention of the evils affecting interstate commerce which Congress found to exist.

Furthermore, section 11 (b) tends to encourage the efficient coordination of geographically related utility properties as opposed to the scatteration and gerrymandering which have characterized the acquisition and control of operating properties by far-flung holding company enterprises.

II. SECTION 11 (B) (1) DOES NOT VIOLATE THE FIFTH AMENDMENT

North American's argument that Section 11 (b) (1) violates the Fifth Amendment is based on two premises: First, that divestment will terminate contractual relationships and thus will involve a deprivation of property without due process of law; and, second, that such evils as were found to exist in public utility holding companies find an adequate remedy in other sections of the Act.

Amici curiae, in their brief, urge further that notice to, and a vote of, security holders are required under the due process clause as a condition to an order under Section 11 (b).

A. SECTION 11 (B) (1) DOES NOT VIOLATE DUE PROCESS BECAUSE OF ITS EFFECT ON VALUES

The validity or invalidity of a statute under the due process clause depends on the question whether the law is unreasonable, arbitrary and capricious, and whether the means selected have a real and substantial relation to the object sought to be obtained. *Nebbia* v. *New York,* 291 U. S. 502, 525. Congress found that substantial evils result from the business of public utility holding companies. (Section 1 of the Act.) We have shown in Part I–C above that Section 11 (b) (1) is reasonably adapted to the amelioration of these evils. Accordingly, Section 11 (b) (1) does not transgress the due process clause. This is true even though it may require the alteration of "vested" property rights. *Mugler* v. *Kansas,* 123 U. S. 623; *Austin* v. *Tennessee,* 179 U. S. 343; *Booth* v. *Illinois,* 184 U. S. 425; *Otis* v. *Parker,* 187 U. S. 606; *Louisville & Nashville R. R. Co.* v. *Mottley,* 219 U. S. 467; *Rast* v. *Van Deman & Lewis Co.,* 240 U. S. 342, 368; *Continental Ins. Co.* v. *United States,* 259 U. S. 156.

Petitioner argues that Section 11, by ordering North American to divest itself of its scattered subsidiaries and to confine its operations to the

single integrated and geographically restricted system of the Union Electric Company of Missouri, involves a taking of property without just compensation. The company relies primarily upon *Louisville Joint Stock Land Bank* v. *Radford*, 295 U. S. 555. In making this argument petitioners assume that the regulation is a reasonable one and that the only question is whether compensation is required. The argument ignores the consequences of the order which is before this Court. The order in question does not take property from any person and give it to another. The security holders of the company who now own interests in the subsidiaries of the North American Company indirectly through investment in the North American Company will, on compliance with the order, hold those same investments in a different form or they will receive cash in full compensation for those investments.

North American's claims of injury in the present case are that investors are deprived of their "right" to pool their investments in the North American Company.[45] The removal of similar

[45] This "right" is asserted to give the security holders a right greater than that of holding interests in the subsidiaries directly, the value of which is asserted to lie in the continuance of the present managing personnel of North American and in the diversity of investment.

North American argues that its security holders will suffer depreciation in the value of their investments, upon compliance with the divestment order. This is speculation.

rights has been held to raise no constitutional barrier in the cases under the Anti-trust laws, e. g., *Northern Securities Co.* v. *United States*, 193 U. S. 197; *Continental Ins. Co.* v. *United States*, 259 U. S. 156.[46]

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and in fact independent statistical services reach a contrary conclusion. According to "The Outlook" (publication of Standard and Poor's Corporation, Vol. 15, No. 3, Section 1, p. 823, March 29, 1943), the estimated liquidating value of the common stock of North American was $21 as of March 13, 1943, as compared with a market price of $12⅝. A similar analysis as of February 9, 1942 (Vol. 13, No. 6, Section 1, p. 936) showed a liquidating value of $16 for North American's common stock as compared with a then market value of $9⅜. As of February 17, 1941 (Vol. 17, No. 7, Section 1, p. 920) the liquidating value was $21 per share and the then marked price was $15 per share. Another financial journal likewise calculates the liquidating value of North American Company stock at $21 per share, and states, in regard to the instant review, "Regardless of the decision which that Court reaches, there seems to be little reason for apprehension by North American Company stockholders." (*Barrons*, April 5, 1943, Vol. XXIII, No. 14, p. 18.) *Moody's Stock Survey*, in January, 1943, stated: "The present liquidating value of the shares is estimated to be appreciably in excess of the current market price." (Vol. 35, No. 3, p. 578.) These figures—representative of those relating to holding companies generally, as the articles in "The Outlook" reveal—indicate that holding company securities sell at substantial discounts from their break-up values, which scarcely betokens opinion on the part of investors that "the whole is greater than the sum of the separate parts" (Pet. Br. 61) in the case of holding companies in general, or North American in particular.

[46] Petitioner and *Amici curiae* argue further that the statute is invalid since it requires disposition of security holdings and the termination of relationships which antedate the passage of the Act. But the statute merely requires that

Further, petitioner argues that the statute and order "involve a vast destruction of values" (Pet. p. 60). In so far as this argument is predicated on the hypothesis that a holding company contributes to the earning power, and therefore to the intrinsic value, of assets which must be divested pursuant to Section 11, the record in this case plainly demonstrates the insubstantiality of the assumption as applied to North American. North American's contribution to the management of its underlying subsidiaries is largely limited to financial matters. The economic value to North American's security holders of such a contribution must be weighed against the added costs incident to maintaining the separate corporate existence of North American, as well as the salary costs of the personnel involved.[47] Moreover, Congress, in the exercise of its legislative judgment, has concluded that the economic advantages, if any, from the spreading of management costs over a vast empire are not commensurate with the economic, social, and political disadvantages, and

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such ownership be no longer continued, and does not penalize past ownership. The Antitrust and Hepburn Act cases make it clear that no constitutional objection can be sustained to a regulation of this type merely because it requires alteration of relations existing prior to the effective date of the statute. See *United States* v. *Trans-Missouri Freight Ass'n*, 166 U. S. 290, 342; *United States* v. *Delaware & Hudson Co.*, 213 U. S. 366.

[47] Three officers of petitioner receive salaries of $75,000 per annum (9 R. 3314, 3315).

this conclusion was amply justified by the studies of the holding company systems which preceded the passage of the Act.

In so far as the argument as to "destruction of values" is predicated on the assumption that in the process of limiting the scope of operations of its holding company there will be dispositions for an inadequate consideration in relation to the value of the assets involved, the argument fails to take into account the reorganization machinery provided in Sections 11 (d) and 11 (e) of the Holding Company Act. Under these provisions the assets of the holding company (i. e., the securities which it owns of its subsidiaries and its miscellaneous investments) need not be sold to outside interests but may be distributed among North American's security holders in accordance with a "fair and equitable reorganization plan." There is provision for determination of the fairness of any such plan, both by the Commission and by the enforcement courts. One such plan was recently before this Court in *Securities and Exchange Commission* v. *Chenery Corp.*, No. 254, decided February 1, 1943. It cannot now be argued, for the purpose of conjuring up obstacles to the entry of an order requiring North American to comply with the provisions of Section 11 (b) (1), that there will be any unfairness in whatever plan may hereafter be approved. North Ameri-

can, of course, makes no such argument but simply ignores the availability of the reorganization machinery in the Act."

As the Senate Committee on Interstate Commerce reported, in reference to a bill containing more drastic limitations of holding companies, but the same enforcement provisions:

> An argument has been given wide-spread currency by the opponents of the title that the elimination of the giant holding companies will demoralize the market for all operating securities because many operating-company securities will be thrown upon the market by the giant holding companies in the course of their dissolution. The argument is premised on the false assumption that the proposed title will cause the dumping or forced liquidation of securities by the giant holding companies. As has been explained above, the title does not require the dumping or forced liquidation of securities. Such disposition as may be necessary can be accomplished by reorganization which will equitably redistribute securities among existing security holders. Insofar as there may be some redistribution of the

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[48] For example, it is not true, as petitioner implies (Pet. Br. 64) that compliance requires payment in cash of existing bondholders and preferred stockholders of North American. A "fair and equitable" plan of compliance might well provide for payment in securities of subsidiary companies in amounts adequate to protect all rights of North American's security holders.

> securities of operating companies through investment banking channels, this will not result in a substantial net increase in the supply of utility securities on the market because for every block of operating securities distributed there will be a corresponding block of holding-company securities retired. The net effect of such changes will be to strengthen the market for utility securities generally by replacing holding-company securities with sound operating-company securities. Such operations, primarily of a refunding nature, should strengthen rather than weaken the credit of operating companies. (S. Rep. No. 621, 74th Cong., 1st sess., p. 16.)

Furthermore, the provisions of the statute are carefully designed to avoid the necessity of unduly rapid liquidation. Holding companies are given a period of at least a year to comply with the Commission's order.[49] The provisions in the Act as to the time for compliance are far more liberal than the time schedule prescribed by this court for compliance with decrees of divestment under the Anti-trust Act. The court in *United States* v. *American Tobacco Co.*, 221 U. S. 106, 187–188, ordered dissolution and reorganization of the American Tobacco Company. It decreed:

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[49] See Section 11 (c) of the Act. This section authorizes the Commission to extend the time for an additional period of a year upon a proper showing.

> * * * for the accomplishment of these purposes, taking into view the difficulty of the situation, a period of six months is allowed from the receipt of our mandate, with leave, however, in the event, in the judgment of the court below, the necessities of the situation require, to extend such period to a further time not to exceed sixty days. * * *

The manner in which compliance is presently being effectuated scarcely supports the contention that hardship is entailed. Petitioner itself, ordered in this proceeding to divest itself of its holdings of Detroit Edison Company common stock, has disposed of such holdings by distributing the stock to petitioner's stockholders over a period of time in lieu of cash dividends, cash being used to retire a portion of petitioner's debentures. *The North American Company,* Holding Company Act Release No. 4056 (1943). In the same manner it has disposed of a portion of its holdings of Washington Railway and Electric Company. A subsidiary of petitioner, North American Light & Power Company, ordered to liquidate under Section 11 (b) (2), has sold some of its assets and retired its publicly held debentures. *North American Light & Power Company,* Holding Company Act Release No. 3658 (1942). See *City National Bank and Trust Co.* v. *S. E. C.* (C. C. A. 7, March 5, 1943).

In other holding company systems, portfolio securities have been exchanged for senior securities of the holding company,[50] and indebtedness has been retired by application of proceeds of sales of portfolio securities.[51]

With respect to the timing of the requirement for compliance, it should be observed that since 1935 North American has been on notice that it must limit its operations in accordance with Section 11. Since January 1936, it has had available to it for this purpose the machinery for voluntary action provided by Section 11 (e) of the Act. It did not choose to avail itself of the provisions of that section; rather it has waited until ordered to comply with the statute.

What the market will do in the future is, and will always be, problematical. Today, the assumption of the North American Company is that it will rise. An assumption equally possible is that

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[50] *Standard Gas and Electric Company*, 7 S. E. C. 1089, 8 S. E. C. 481; *National Power and Light Company*, Holding Company Act Release No. 3211 (1941); *Federal Water and Gas Corporation*, Holding Company Act Release No. 4113 (1943); *United Gas Improvement Company*, Holding Company Act Release No. 4173 (1943); *Lone Star Gas Corporation*, Holding Company Act Release No. 3865 (1942).

[51] *United Light & Power Company*, Holding Company Act Release No. 3345 (1942), see *New York Trust Co.* v. *Securities and Exchange Commission*, 131 F. (2d) 274 (C. C. A. 2); *Central States Utilities Corporation*, Holding Company Act Release No. 3947 (1942).

it may fall. In such case disposition or reorganization within the near future may result in preventing a further decrease in the value of the common stock. Certainly the speculative possibility that a more favorable market will occur at some time in the future, or that retention of an investment will be more advantageous financially than its disposition, are not of such substance as to raise doubts concerning the constitutionality of a carefully worked out Congressional policy.

B. 11 (B) (1) IS AN APPROPRIATE REMEDY FOR THE EVILS EXISTING IN PUBLIC UTILITY HOLDING COMPANIES DESPITE THE APPLICATION OF OTHER REMEDIES FOR SOME OF THE SAME EVILS

North American, contending that Section 11 (b) (1) is not an appropriate method of abolishing the existing abuses, refers in detail to other sections of the Act which regulate specific activities of holding companies and their subsidiaries.

The basic difficulty with this approach is that it totally fails to recognize that in large part the other sections mentioned regulate future transactions by holding companies rather than provide for eliminating the existing conditions that Congress has found adversely affect the national public interest. To be sure, Congress might have determined that by regulating future transactions it would in time achieve its goal. As we have pointed out, Congress concluded that this would be an inadequate solution. But in any event it

was a question for Congressional discretion, rather than a question of Congressional power, whether is was desirable to allow the evils to continue until the completion of a long-drawn-out process of curing them by regulating future transactions.

Once it is established that a means selected by Congress is adapted to remedy a situation within Congressional power, the appropriateness of the remedy chosen by Congress is, of course, a matter for Congress. In *Sunshine Anthracite Coal Co.* v. *Adkins*, 310 U. S. 381, 394, the Court said:

> But appellant claims that this Act is not an appropriate exercise of the Congressional power. It urges that the nature and use of bituminous coal in nowise endanger the health and morals of the populace * * * that the increase of prices will * * * add to the afflictions which beset the industry; * * *. Those matters, however, relate to questions of policy, to the wisdom of the legislation, and to the *appropriateness of the remedy chosen—matters which are not our concern.* If we endeavored to appraise them we would be trespassing on the legislative domain. * * *

As the court below held:

> Congress did not think it could accomplish its object solely by regulating future transactions, although many of the provisions of the Act apply only to them * * *

> The wisdom of the legislation and the appropriateness of the remedy chosen is not the concern of the courts.

It is clear in any event, from what has been stated in Point I C above, that the method chosen by Congress in Section 11 (b) (1) to meet the evils inherent in the business of holding companies is reasonably adapted to the end sought.

Finally, the provisions regulating future activities are not adequate to deal with the major matters of concern under Section 11. Particularly is this so with reference to Section 11 (b) (1) here in litigation. As a remedy for evils which Congress found to exist "when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties," petitioner suggests that existing lack of integration and coordination is subject to the power of the Federal Power Commission to compel the physical connection of transmission facilities (Pet. Br. 69, Item 9). It is clear that the mere interconnection of facilities, were it possible, would not make an integrated and related whole of scattered and functionally unrelated properties. Concretely, this argument is that the existing uneconomic and uncoordinated situation of the properties of the North American Company could be cured merely by running a transmission line

from the District of Columbia through Cleveland, Milwaukee, and St. Louis to San Francisco. Even were such an engineering feat possible, it could not make of the scattered properties of the North American Company an integrated and related whole. So it is clear that the remedies provided elsewhere than in Section 11 (b) (1) are not of themselves sufficient to meet the evils which Congress found to exist. The same defect appears in petitioner's treatment of Section 11 (b) (2) (see Pet. Br. 69, Item 8).

C. THE PROCEDURE PROVIDED IN SECTION 11 DOES NOT VIOLATE DUE PROCESS

Amici curiae raise the objection, not made by petitioner, that the statute is defective for want of a requirement of notice to, and vote by, security holders. It is difficult to fathom just what the *amici* would wish the security holders to vote on. They cite cases regarding voting by security holders on plans of reorganization, but here there is as yet no such plan. The only determination that has been made thus far is a determination of what end result must be reached to comply with the provisions of the Act. Would the *amici* wish to submit to a vote of security holders the question whether North American should comply with the Act and the further question as to what the Act requires of North American? Clearly the matters thus far

determined by the Commission have not been of a kind appropriate for submission to a vote of security holders. This was explicitly held by the Circuit Court of Appeals for the Third Circuit in *Commonwealth and Southern Corp.* v. *Securities and Exchange Commission,* March 31, 1943.

Asserting that "There is something startling" (Brief of *Amici Curiae,* p. 45) about a divestment order without a vote of security holders, *amici* ask: "Why has this not been done in the railroad field?" (p. 46). The short answer is that it has been done in the railroad field. *Northern Securities Co.* v. *United States,* 193 U. S. 197; *United States* v. *Union Pacific R. Co.,* 226 U. S. 61. And it has been done in other fields as well. *United States* v. *American Tobacco Co.,* 221 U. S. 106; *Continental Ins. Co.* v. *United States,* 259 U. S. 156.

When a plan of compliance with the Section 11 (b) (1) order is evolved, the question whether there should be a vote of security holders will properly arise. In regard to Section 11 (e) plans, the Commission has stated its position in *Great Lakes Utility Company,* Holding Company Act Release No. 3419 (1942):

> The plan does not provide for submission of the Amended Plan to security holders for their approval. Neither Section 11 (e) nor 11 (d) contain requirements for

obtaining security holders' approval, and in view of overriding considerations of public policy, it was obviously intended by Congress that a plan found by this Commission, and by a Federal Court, to be fair and equitable to persons affected, and necessary and appropriate to effectuate the provisions of Section 11, could be approved and carried out whether or not such assent should be given. Nevertheless, it may frequently be desirable to submit such plans to the vote of security holders, or at least to those classes of security holders having the major stake in the plan. In this instance we are of the opinion that submission of the plan to security holders should be dispensed with in the interest of economy. Among the considerations which justify dispensing with such vote in this case are the relatively brief extension of the maturity of the bonds, the fact that the plan contemplates liquidation and the exercise of jurisdiction over the assets of the company by a court of equity, and that, under the conditions imposed by our order, the extension of the majority of the bonds is to be without prejudice to the right of any bondholders to be heard by the court as to any issues which may arise during the extension period concerning the program of liquidation by the management, in the event that such action appears necessary in the interest of the bondholders.

CONCLUSION

For the reasons stated, the judgment below should be affirmed.

Respectfully submitted.

CHARLES FAHY,
Solicitor General.
PAUL A. FREUND,
Special Assistant to the Attorney General.
JOHN F. DAVIS,
Solicitor,
MILTON V. FREEMAN,
Assistant Solicitor,
ROGER S. FOSTER,
Counsel, Public Utilities Division,
DAVID K. KADANE,
Securities and Exchange Commission.

APRIL 1943.

APPENDIX A

The Public Utility Holding Company Act of 1935, c. 687, 49 Stat. 803, 15 U. S. C., sec. 79 *et seq.*, provides in pertinent part as follows:

TITLE I—CONTROL OF PUBLIC-UTILITY HOLDING COMPANIES

NECESSITY FOR CONTROL OF HOLDING COMPANIES

SECTION 1. (a) Public-utility holding companies and their subsidiary companies are affected with a national public interest in that, among other things, (1) their securities are widely marketed and distributed by means of the mails and instrumentalities of interstate commerce and are sold to a large number of investors in different States; (2) their service, sales, construction, and other contracts and arrangements are often made and performed by means of the mails and instrumentalities of interstate commerce; (3) their subsidiary public-utility companies often sell and transport gas and electric energy by the use of means and instrumentalities of interstate commerce; (4) their practices in respect of and control over subsidiary companies often materially affect the interstate commerce in which those companies engage; (5) their activities extending over many States are not susceptible of effective control by any State and make difficult, if not impossible, effective State regulation of public-utility companies.

(b) Upon the basis of facts disclosed by the reports of the Federal Trade Commission made pursuant to S. Res. 83 (Seventieth Congress, first session), the reports of the Committee on Interstate and Foreign Commerce, House of Representatives, made pursuant to H. Res. 59 (Seventy-second Congress, first session) and H. J. Res. 572 (Seventy-second Congress, second session) and otherwise disclosed and ascertained, it is hereby declared that the national public interest, the interest of investors in the securities of holding companies and their subsidiary companies and affiliates, and the interest of consumers of electric energy and natural and manufactured gas, are or may be adversely affected—

(1) when such investors cannot obtain the information necessary to appraise the financial position or earning power of the issuers, because of the absence of uniform standard accounts; when such securities are issued without the approval or consent of the States having jurisdiction over subsidiary public-utility companies; when such securities are issued upon the basis of fictitious or unsound asset values having no fair relation to the sums invested in or the earning capacity of the properties and upon the basis of paper profits from intercompany transactions, or in anticipation of excessive revenues from subsidiary public-utility companies; when such securities are issued by a subsidiary public-utility company under circumstances which subject such company to the burden of supporting an overcapitalized structure and tend to prevent voluntary rate reductions;

(2) when subsidiary public-utility companies are subjected to excessive charges

for services, construction work, equipment, and materials, or enter into transactions in which evils result from an absence of arm's-length bargaining or from restraint of free and independent competition; when service, management, construction, and other contracts involve the allocation of charges among subsidiary public-utility companies in different States so as to present problems of regulation which cannot be dealt with effectively by the States;

(3) when control of subsidiary public-utility companies affects the accounting practices and rate, dividend, and other policies of such companies so as to complicate and obstruct State regulation of such companies, or when control of such companies is exerted through disproportionately small investment;

(4) when the growth and extension of holding companies bears no relation to economy of management and operation or the integration and coordination of related operating properties; or

(5) when in any other respect there is lack of economy of management and operation of public-utility companies or lack of efficiency and adequacy of service rendered by such companies, or lack of effective public regulation, or lack of economies in the raising of capital.

(c) When abuses of the character above enumerated become persistent and widespread the holding company becomes an agency which, unless regulated, is injurious to investors, consumers, and the general public; and it is hereby declared to be the policy of this title, in accordance with which policy all the provisions of this title shall be interpreted, to meet the problems and eliminate the evils as enumerated in

this section, connected with public-utility holding companies which are engaged in interstate commerce or in activities which directly affect or burden interstate commerce; and for the purpose of effectuating such policy to compel the simplification of public-utility holding-company systems and the elimination therefrom of properties detrimental to the proper functioning of such systems, and to provide as soon as practicable for the elimination of public-utility holding companies except as otherwise expressly provided in this title.

DEFINITIONS

SEC. 2. (a) When used in this title, unless the context otherwise requires—

* * * * *

(7) "Holding company" means—

(A) any company which directly or indirectly owns, controls, or holds with power to vote, 10 per centum or more of the outstanding voting securities of a public-utility company or of a company which is a holding company by virtue of this clause or clause (B), unless the Commission, as hereinafter provided, by order declares such company not to be a holding company; and

(B) any person which the Commission determines, after notice and opportunity for hearing, directly or indirectly to exercise (either alone or pursuant to an arrangement or understanding with one or more other persons) such a controlling influence over the management or policies of any public-utility or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that such person be subject to the obligations, duties, and lia-

bilities imposed in this title upon holding companies.

The Commission, upon application, shall by order declare that a company is not a holding company under clause (A) if the Commission finds that the applicant (i) does not, either alone or pursuant to an arrangement or understanding with one or more other persons, directly or indirectly control a public-utility or holding company either through one or more intermediary persons or by any means or device whatsoever, (ii) is not an intermediary company through which such control is exercised, and (iii) does not, directly or indirectly, exercise (either alone or pursuant to an arrangement or understanding with one or more other persons) such a controlling influence over the management or policies of any public-utility or holding company as to make it necessary or appropriate in the public interest or for the protection of investors or consumers that the applicant be subject to the obligations, duties, and liabilities imposed in this title upon holding companies. The filing of an application hereunder in good faith by a company other than a registered holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company, until the Commission has acted upon such application. Within a reasonable time after the receipt of any application hereunder, the Commission shall enter an order granting, or, after notice and opportunity for hearing, denying or otherwise disposing of, such application. As a condition to the entry of any order granting such application and as a part of

any such order, the Commission may require the applicant to apply periodically for a renewal of such order and to do or refrain from doing such acts or things, in respect of exercise of voting rights, control over proxies, designation of officers and directors, existence of interlocking officers, directors and other relationships, and submission of periodic or special reports regarding affiliations or intercorporate relationships of the applicant, as the Commission may find necessary or appropriate to ensure that in the case of the applicant the conditions specified in clauses (i), (ii), and (iii) are satisfied during the period for which such order is effective. The Commission, upon its own motion or upon application of the company affected, shall revoke the order declaring such company not to be a holding company whenever in its judgment any condition specified in clause (i), (ii), or (iii) is not satisfied in the case of such company, or modify the terms of such order whenever in its judgment such modification is necessary to ensure that in the case of such company the conditions specified in clauses (i), (ii), and (iii) are satisfied during the period for which such order is effective. Any action of the Commission under the preceding sentence shall be by order.

* * * * *

POWER TO MAKE PARTICULAR EXEMPTIONS REGARDING HOLDING COMPANIES, SUBSIDIARY COMPANIES, AND AFFILIATES

SEC. 3. (a) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any holding company, and every subsidiary

company thereof as such, from any provision or provisions of this title, unless and except insofar as it finds the exemption detrimental to the public interest or the interest of investors or consumers, if—

(1) such holding company, and every subsidiary company thereof which is a public-utility company from which such holding company derives, directly or indirectly, any material part of its income, are predominantly intrastate in character and carry on their business substantially in a single State in which such holding company and every such subsidiary company thereof are organized;

(2) such holding company is predominantly a public-utility company whose operations as such do not extend beyond the State in which it is organized and States contiguous thereto;

(3) such holding company is only incidentally a holding company, being primarily engaged or interested in one or more businesses other than the business of a public-utility company and (A) not deriving, directly or indirectly, any material part of its income from any one or more subsidiary companies, the principal business of which is that of a public-utility company, or (B) deriving a material part of its income from any one or more such subsidiary companies, if substantially all the outstanding securities of such companies are owned, directly or indirectly, by such holding company;

(4) such holding company is temporarily a holding company solely by reason of the acquisition of securities for purposes of liquidation or distribution in connection with a bona fide debt previously contracted

or in connection with a bona fide arrangement for the underwriting or distribution of securities; or

(5) such holding company is not, and derives no material part of its income, directly or indirectly, from any one or more subsidiary companies which are, a company or companies the principal business of which within the United States is that of a public-utility company.

(b) The Commission, by rules and regulations upon its own motion, or by order upon application, shall exempt any subsidiary company, as such, of a holding company from any provision or provisions of this title, the application of which to such subsidiary company the Commission finds is not necessary in the public interest or for the protection of investors, if such subsidiary company derives no material part of its income, directly or indirectly, from sources within the United States, and neither it nor any of its subsidiary companies is a public-utility company operating in the United States.

(c) Within a reasonable time after the receipt of an application for exemption under subsection (a) or (b), the Commission shall enter an order granting, or, after notice and opportunity for hearing, denying or otherwise disposing of such application. The filing of an application in good faith under subsection (a) by a person other than a registered holding company shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a holding company until the Commission has acted upon such application. The filing of an application in good faith under sub-

section (b) shall exempt the applicant from any obligation, duty, or liability imposed in this title upon the applicant as a subsidiary company until the Commission has acted upon such application. Whenever the Commission, on its own motion, or upon application by the holding company or any subsidiary company thereof exempted by any order issued under subsection (a), or by the subsidiary company exempted by any order issued under subsection (b), finds that the circumstances which gave rise to the issuance of such order no longer exist, the Commission shall by order revoke such order.

(d) The Commission may, by rules and regulations, conditionally or unconditionally exempt any specified class or classes of persons from the obligations, duties, or liabilities imposed upon such persons as subsidiary companies or affiliates under any provision or provisions of this title, and may provide within the extent of any such exemption that such specified class or classes of persons shall not be deemed subsidiary companies or affiliates within the meaning of any such provision or provisions, if and to the extent that it deems the exemption necessary or appropriate in the public interest or for the protection of investors or consumers and not contrary to the purposes of this title.

TRANSACTIONS BY UNREGISTERED HOLDING COMPANIES

SEC. 4. (a) After December 1, 1935, unless a holding company is registered under section 5, it shall be unlawful for such holding company, directly or indirectly—

(1) to sell, transport, transmit, or dis-

tribute, or own or operate any utility assets for the transportation, transmission, or distribution of natural or manufactured gas or electric energy in interstate commerce;

(2) by use of the mails or any means or instrumentality of interstate commerce, to negotiate, enter into, or take any step in the performance of, any service, sales, or construction contract undertaking to perform services or construction work for, or sell goods to, any public-utility company or holding company;

(3) to distribute or make any public offering for sale or exchange of any security of such holding company, any subsidiary company or affiliate of such holding company, any public-utility company, or any holding company, by use of the mails or any means or instrumentality of interstate commerce, or to sell any such security having reason to believe that such security, by use of the mails or any means or instrumentality of interstate commerce, will be distributed or made the subject of a public offering;

(4) by use of the mails or any means or instrumentality of interstate commerce, to acquire or negotiate for the acquisition of any security or utility assets of any subsidiary company or affiliate of such holding company, any public-utility company, or any holding company;

(5) to engage in any business in interstate commerce; or

(6) to own, control, or hold with power to vote, any security of any subsidiary company thereof that does any of the acts enumerated in paragraphs (1) to (5), inclusive, of this subsection.

(b) Every holding company which has outstanding any security any of which, by use of the mails or any means or instrumentality of interstate commerce, has been distributed or made the subject of a public offering subsequent to January 1, 1925, and any of which security is owned or held on October 1, 1935 (or, if such company is not a holding company on that date, on the date such company becomes a holding company) by persons not resident in the State in which such holding company is organized, shall register under section 5 on or before December 1, 1935 or the thirtieth day after such company becomes a holding company, whichever date is later.

* * * * *

SEC. 11.

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(b) It shall be the duty of the Commission, as soon as practicable after January 1, 1938:

(1) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such action as the Commission shall find necessary to limit the operations of the holding-company system of which such company is a part to a single integrated public-utility system, and to such other businesses as are reasonably incidental, or economically necessary or appropriate to the operations of such integrated public-utility system: *Provided, however,* That the Commission shall permit a registered holding company to continue to control one or more additional integrated public-utility systems, if, after notice and opportunity for hearing, it finds that—

(A) Each of such additional systems cannot be operated as an independent system without the loss of substantial economies which can be secured by the retention of control by such holding company of such system;

(B) All of such additional systems are located in one State, or in adjoining States, or in a contiguous foreign country; and

(C) The continued combination of such systems under the control of such holding company is not so large (considering the state of the art and the area or region affected) as to impair the advantages of localized management, efficient operation, or the effectiveness of regulation.

The Commission may permit as reasonably incidental, or economically necessary or appropriate to the operations of one or more integrated public-utility systems the retention of an interest in any business (other than the business of a public-utility company as such) which the Commission shall find necessary or appropriate in the public interest or for the protection of investors or consumers and not detrimental to the proper functioning of such system or systems.

(2) To require by order, after notice and opportunity for hearing, that each registered holding company, and each subsidiary company thereof, shall take such steps as the Commission shall find necessary to ensure that the corporate structure or continued existence of any company in the holding-company system does not unduly or unnecessarily complicate the structure, or unfairly or inequitably distribute voting power among security holders, of such holding-company system.

In carrying out the provisions of this paragraph the Commission shall require each registered holding company (and any company in the same holding-company system with such holding company) to take such action as the Commission shall find necessary in order that such holding company shall cease to be a holding company with respect to each of its subsidiary companies which itself has a subsidiary company which is a holding company. Except for the purpose of fairly and equitably distributing voting power among the security holders of such company, nothing in this paragraph shall authorize the Commission to require any change in the corporate structure or existence of any company which is not a holding company, or of any company whose principal business is that of a public-utility company.

The Commission may by order revoke or modify any order previously made under this subsection, if, after notice and opportunity for hearing, it finds that the conditions upon which the order was predicated do not exist. Any order made under this subsection shall be subject to judicial review as provided in section 24.

APPENDIX B*

Name of system	Approximate consolidated assets Dec. 31, 1941	Location of general headquarters[1]	Number of utility subsidiaries[2]	Number of States where subsidiaries operate	Maximum distance headquarters to subsidiaries[3]	Average distance headquarters to subsidiaries[3]
Electric Bond & Share Co.[4]	$586,071,057	New York area[5]	11	8	800	500
American Gas & Electric Co.	851,251,525	New York area[5]	17	14	3,100	2,000
American Power & Light Co.	749,183,549	New York area[5]	9	10	2,700	1,800
Electric Power & Light Co.	542,078,708	New York area[5]	6	5	1,630	900
National Power & Light						
United Corporation Group[6]	709,099,107	New York area[5]	27	8	825	600
Columbia Gas & Elec. Corp., The	1,168,010,[illegible]	New York area[5]	10	10	1,350	900
Commonwealth & Southern Corp., The	645,325,[illegible]	New York	9	1	300	200
Niagara Hudson Power Corp.	1,446,813,044	Philadelphia	25	9	2,500	250
United Gas Improvement Co., The[7]	484,320,934	New York	14	5	575	400
American Water Works and Electric Co., Inc.	1,043,325,684	New York	64	26	2,500	600
Associated Gas & Electric Corp.	109,380,904	New York area[5]	37	18	1,650	600
Central Public Utility Corp.	1,026,837,666	New York area[5]	33	15	3,200	1,600
Cities Service Co.	386,234,239	New York area[5]	19	15	3,100	1,650
Engineers Public Service Co.	198,168,300	New York area[5]	8	4	1,350	750
Federal Water and Gas Corp.	629,547,543					
International Hydro-Electric System[8]	153,371,919	Dallas	6	3	700	300
Lone Star Gas Corporation	502,371,709	Chicago	26	15	1,300	525
Middle West Corporation, The	294,660,318	Chicago	13	3	300	
Midland United Company	108,649,716	New York area	9	2	400	360
National Fuel Gas	106,587,213	Cambridge, Mass.	18	5	[illegible]125	
New England Gas & Electric Association	207,157,937	Augusta	6	3	250	
New England Public Service Company	1,320,480,301	New York area	21	12	1,400	1,000
North American Company, The						
Northern State Power Co.	267,630,883	Minneapolis	8	3	(9)	(9)
Ogden Corporation	109,765,002	New York	11	7	(9)	(9)
Portland Electric Power Co.	112,570,873	Portland, Oreg.	2	2	200	
Standard Power and Light Corp.	823,842,714	Chicago	26	21	2,300	600
United Light and Power Co., The	572,958,641	Chicago	25	13	1,250	450
Total	15,334,026,827					

[1] Includes Public Service Corporation of New Jersey.

[2] Data at Dec. 6, 1939.

[3] New York area includes New York City, Newark, and Jersey City.

[4] For 17 companies: 18th, 400 miles.

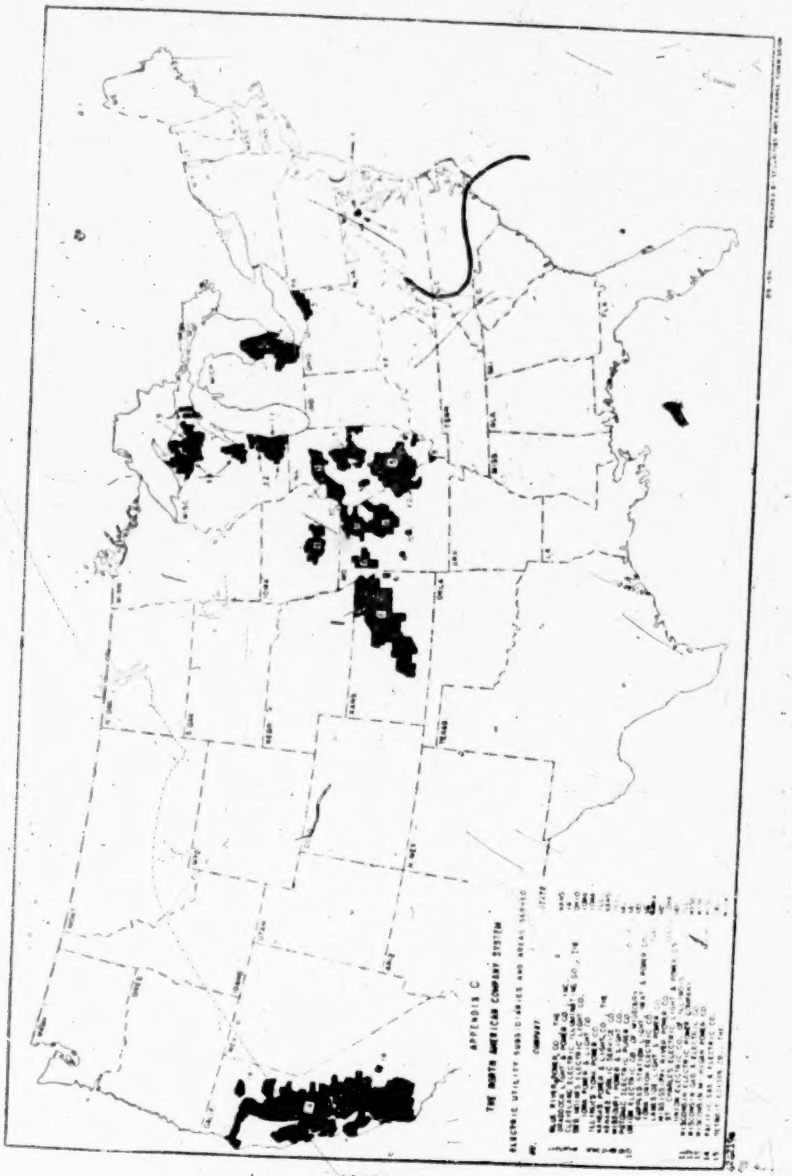
[5] A substantial portion of assets represented by New England Power Association, headquarters in Boston, subsidiaries within a radius of 275 miles. Other important subsidiaries are in New York State and in the Province of Quebec.

[6] Part of Standard Power and Light Corp. Group as of Dec. 6, 1939.

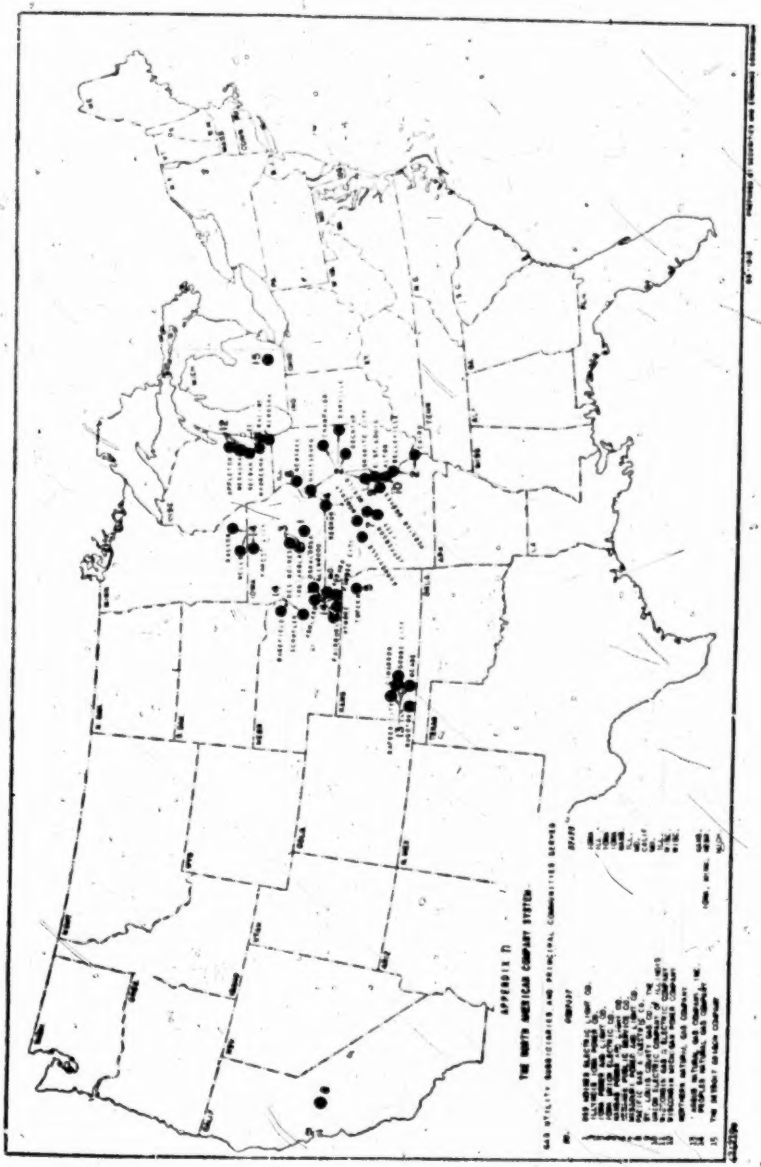
[7] Ogden Corporation under control of reorganization court on Dec. 6, 1939, under former name—Utilities Power and Light Corporation.

* SOURCE: Report of Public Utilities Division, Securities and Exchange Commission, "Charts Showing Location of Operating Electric and/or Gas Subsidiaries of Registered Public Utility Holding Companies, 1939," Dec. 6, 1939; for assets shown in second column, statement filed with the Commission by the holding companies.

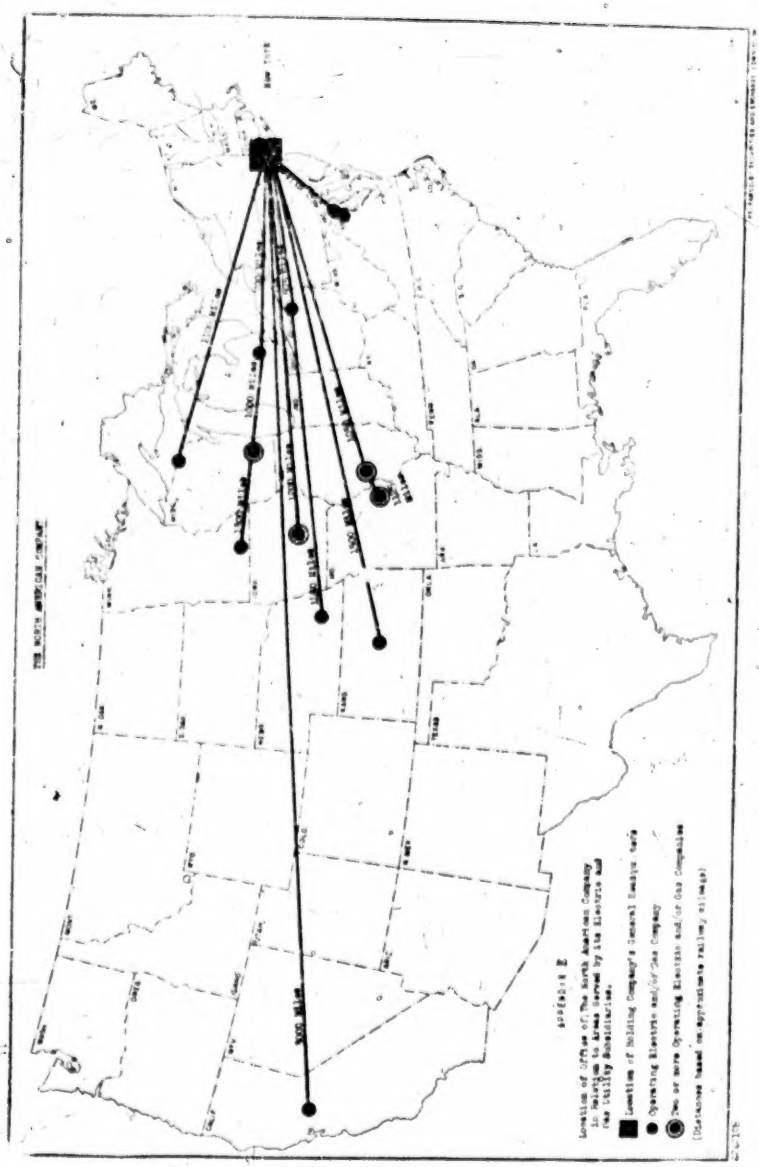
APPENDIX C



APPENDIX D



APPENDIX E



U. S. GOVERNMENT PRINTING OFFICE: 1943